Report on Operations Under the European Bank for Reconstruction and Development Agreement Act 1998

Canada

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INTRODUCTION

The European Bank for Reconstruction and Development (referred to in this document as the EBRD or the Bank) was established in 1991. Its aim is to foster the transition towards open, market-oriented economies in Central and Eastern Europe, as well as in the successor republics of the Soviet Union, and to promote private and entrepreneurial initiative in countries in this region that are committed to the fundamental principles of multi-party democracy, pluralism and a market economy (see Annex 4 for a list of the EBRD's 26 countries of operation).

The EBRD functions as a development bank, much in the same way that the World Bank and other regional development banks operate. The EBRD, however, is distinctive in three areas. First, its overriding focus is on the private sector and support for the transition from central planning to stable market economies. Its Charter stipulates that not less than 60 per cent of its financing commitments should be directed either to private sector enterprises or to state-owned enterprises implementing a program to achieve private ownership and control. Second, the EBRD's mandate gives it a particular focus on the promotion of democratic institutions and human rights in its countries of operation. Finally, the EBRD is explicitly committed to ensuring the environmental sustainability of all its projects.

The Bank seeks to help its 26 countries of operation to implement structural and sectoral economic reforms, taking into account the particular needs of countries at different stages in the transition process. In particular, its private sector activities focus mainly on enterprise restructuring, including the strengthening of financial institutions, and the development of infrastructure needed to support the private sector. The EBRD has 60 members (58 countries, the European Union and the European Investment Bank – see Annex 4 for a list of the members).

Canada is the eighth largest shareholder, following the other Group of Seven (G-7) countries and the Russian Federation. Our formal participation is authorized under the *European Bank for Reconstruction and Development Agreement Act,* which was promulgated in February 1991. Article 7 of the Act states that:

> "The Minister [of Finance] shall cause to be laid before each House of Parliament by March 31 of each year, or if that House is not then sitting, on any of the thirty days next thereafter that it is sitting, a report of operations for the previous calendar year, containing a general summary of all actions taken under the authority of this Act, including their sustainable development aspects within the meaning of Article 2 of the Agreement, and their human rights aspects."

This report responds to this requirement and reviews the activities and operations of the Bank for the year 1998.

ROLE AND MANDATE OF THE EBRD

The EBRD:

- fosters the transition of former centrally planned economies of Central and Eastern Europe and the Commonwealth of Independent States towards market-oriented economies;
- promotes private entrepreneurial initiative (targets at least 60 per cent of its resources to private sector projects with the balance in support of commercially viable state sector projects that promote private sector development);
- operates only in countries committed to applying the principles of multi-party democracy, pluralism and market economics;
- promotes environmentally sound and sustainable development;
- operates on a self-financing basis.

The EBRD's operations to advance the transition to a market economy are guided by three principles: maximizing transition impact, additionality and sound banking. Financing is provided for projects that expand and improve markets, help build the institutions necessary for underpinning the market economy, and demonstrate and promote market-oriented skills and sound business practices. EBRD financing must also be additional to other sources of financing, and not displace it, further ensuring the Bank contributes to the transition process. Finally, Bank projects must be sound from a banking perspective, thus demonstrating to private investors that the region offers sound returns. Adherence to the sound banking principle also helps ensure the financial viability of the EBRD and hence its attractiveness as a co-investment partner for the private sector.

In promoting economic transition in its countries of operation, the Bank acts as a catalyst for increased flows of financing to the private sector. The capital requirements of these countries cannot be fully met by official multilateral and bilateral sources of financing, and many foreign private investors remain hesitant to invest in the region. By providing an umbrella under which wider funding for private sector investment can be assembled, the EBRD plays a catalytic role in mobilizing capital. In 1998, for every ECU the EBRD invested, it mobilized an additional 3.2 ECU from the private sector and multilateral and bilateral agencies.[1]

[1] The European Currency Unit, or ECU, is a weighted basket of 12 European currencies. On December 31, 1998, one ECU purchased 1.7943 Canadian dollars.

Indeed, the projects of the Bank serve a dual purpose. They are intended not only to directly support the transition from a command to a market economy in countries of operation, but also to create a demonstration effect to attract foreign and domestic investors. Like the International Finance Corporation, the Bank is required to operate on a strictly commercial basis and to attract companies to invest in countries through financially viable projects, not through subsidies.

KEY DEVELOPMENTS IN 1998

In 1998, the EBRD faced its most serious operational challenge in its seven-year history. Falling investor confidence in emerging markets worldwide in the wake of events in East Asia, combined with incomplete macroeconomic and structural reform efforts in Russia, precipitated a financial crisis in Russia in August 1998. Russia's already fragile banking system was seriously affected and the impact reverberated through some of the other transition economies. The financial and economic pressures arising from this crisis led to the largest reform setbacks in Russia since the collapse of communism in 1991 and to significant reform reversals in several other transition economies (mainly members of the Commonwealth of Independent States (CIS)).

The suddenness and depth of the Russian financial crisis proved a stress test for reform and restructuring across all of the EBRD's countries of operation. Significantly, those countries (principally in Central and Eastern Europe) that have been most committed to reform and have moved the furthest in creating strong state and corporate institutions proved best able to weather the financial turbulence. The following table classifies transition countries according to a number of transition indicators.

Progress in Transition in Central and Eastern Europe, the Baltic States and the CIS[1]

			Enterprises			Market and trade			Financial institutions	
Countries	Population (millions, 1997)	Private sector share of GDP in %, mid-1998	Large-scale privatization	Small-scale privatization	Governance and enterprise restructuring	Price liberal-ization	Trade and foreign exchange system	Compe-tition policy	Banking reform and interest rate liberalization	Securities markets and non-bank financial institutions
Albania	3.2	75	2	4	2	3	4	2	2	2-
Armenia	3.7	60	3	3	2	3	4	2	2+	2
Azerbaijan	7.6	45	2	3	2	3	3	1	2	2-
Belarus	10.2	20	1	2	1	2	1	2	1	2
Bosnia and Herzegovina	4.1	35	2	2	2-	3	2	1	2	1
Bulgaria	8.3	50	3	3	2+	3	4	2	3-	2
Croatia	4.5	55	3	4+	3-	3	4	2	3-	2+
Czech Republic	10.3	75	4	4+	3	3	4+	3	3	3
Estonia	1.5	70	4	4+	3	3	4	3-	3+	3
FYR Macedonia	2.0	55	3	4	2	3	4	1	3	2-
Georgia	5.4	60	3+	4	2	3	4	2	2+	1
Hungary	10.1	80	4	4+	3+	3+	4+	3	4	3+
Kazakhstan	15.7	55	3	4	2	3	4	2	2+	2
Kyrgyzstan	4.6	60	3	4	2	3	4	2	3-	2
Latvia	2.5	60	3	4	3-	3	4	3-	3-	2+
Lithuania	3.7	70	3	4	3-	3	4	2+	3	2+
Moldova	4.3	45	3	3+	2	3	4	2	2+	2
Poland	38.7	65	3+	4+	3	3+	4+	3	3+	3+
Romania	22.5	60	3-	3+	2	3	4	2	2+	2
Russian Federation	147.2	70	3+	4	2	3-	2+	2+	2	2-
Slovak Republic	5.4	75	4	4+	3-	3	4+	3	3-	2+
Slovenia	2.0	55	3+	4+	3-	3	4+	2	3	3
Tajikistan	6.1	30	2	2+	2-	3	3-	1	1	1
Turkmenistan	4.7	25	2-	2	2-	2	1	1	1	1
Ukraine	50.9	55	2+	3+	2	3	3-	2	2	2
Uzbekistan	23.6	45	3-	3	2	2	2-	2	2-	2

Source: *Transition Report* (EBRD, November 1998)

[1] The classification of transition indicators uses a scale from 1 to 4 where 1 implies little or no progress with reform and 4 implies a market economy. Most advanced industrial economies would qualify for the 4+ rating for almost all the transition indicators.

Highlights of Macroeconomic Performance

- Due to the impact of the Russian crisis, real GDP declined by an estimated 1 per cent in the EBRD's region of operation in 1998. However, this masks significant variations across countries. In the CIS countries, output fell by an estimated 3.6 per cent; in contrast, Central and Eastern Europe and the Baltic States grew an estimated 2.8 per cent.
- Inflation has continued to fall in most countries, helped by low commodity prices and the tightening of domestic liquidity following capital outflows from the region during the second half of the year. However, in a number of other countries inflation has picked up substantially, most notably in Russia, due to significant exchange rate depreciation.
- Current account deficits widened in the region in 1998. Fifteen countries recorded deficits above 7 per cent of GDP compared with nine in 1997.

Russia

The origins of the Russian crisis lay in the country's incomplete macroeconomic stabilization and slow pace of structural reform (especially at the enterprise level). Since 1995, the Russian government had used domestic Treasury bills and international capital market borrowing to finance fiscal deficits. With the persistence of the emerging markets financial crisis since mid-1997, Russia also had to contend with rising borrowing costs and falling commodity prices. As the stock of debt grew, without progress in reducing government deficits, domestic and foreign holders of Russian debt instruments lost confidence. In response to the escalating cost of debt financing and pressure on the ruble, on August 17, 1998, the Russian government suspended payments on its ruble-denominated debt obligations, announced a moratorium on foreign debt payments and effectively devalued the ruble. (It depreciated 60 per cent against the US dollar in the wake of the crisis, and by the end of December 1998 had depreciated 70 per cent relative to its pre-crisis level.) In the wake of the crisis, the President dismissed the reform-oriented government of the Russian Federation.

Heavily exposed to the Russian government and with considerable unhedged foreign exchange liabilities, Russian commercial banks were severely affected by the default and devaluation; many collapsed. The new Russian government, under Prime Minister Yevgeny Primakov, has begun to build some political consensus but has not been able to elaborate an effective recovery program. As a result, the International Monetary Fund has suspended financial assistance to Russia though it continues to dialogue with the government. The lack of an effective recovery program continues to undermine the restoration of investor confidence.

Central and Eastern Europe

In contrast to Russia, several central and eastern European (CEE) countries continued to enjoy relatively robust economic growth in 1998; average real growth for these countries has been above 3.5 per cent since 1994. In 1998, the Slovak Republic and Slovenia joined Poland among the CEE countries where income levels exceeded those of a decade ago. Economic growth in 1998 for the region, though lower than in 1997, was still positive at an estimated 2.8 per cent. However, there was a noticeable weakening in the regional growth rate in the second half of the year.

In 1998, CEE economic growth rates significantly exceeded those of the CIS region. This was due in part to the CEE's relatively low trade dependence on Russia and its ability to withstand the emerging markets financial crisis better than CIS countries. This stronger macroeconomic position has been fostered by significant gains in competitiveness through successful enterprise restructuring and by the creation of strong market-supporting institutions (fiscal, legal, financial and social) in many CEE countries. Poland and Hungary in particular advanced significantly in the transition process (see the table on page 8) and were well poised for long-term sustained economic growth.

Accession to the European Union

The main challenge for the more advanced CEE countries in 1998 was working towards meeting the requirements for accession to the European Union (EU). In March 1998, the EU began initial accession negotiations with five (the Czech Republic, Estonia, Hungary, Poland and Slovenia) of the ten "accession countries" identified in December 1997 at the EU's Intergovernmental Council meeting as candidates for early membership.[1]

In the same month the EBRD, European Commission and World Bank signed a Memorandum of Understanding setting out the basic principles for collaboration in supporting projects that will assist all accession countries in meeting the requirements of EU accession. In particular, all 10 accession countries face specific requirements for investment in infrastructure to meet the requirements of the EU's Acquis Communautaire. The EBRD will be active in supporting projects where its mandate and EU accession requirements overlap.

[1] The ten accession countries are Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia. The EU has negotiated accession partnerships with all 10 countries.

The Non-Russian CIS

Given its considerable trade dependence on Russia, the CIS region was profoundly affected by the Russian financial crisis. Growth slowed in seven of the eleven CIS countries (excluding Russia), with those countries trading most heavily with Russia experiencing some of the most significant slowdowns. For instance, in Moldova, where 63 per cent of merchandise exports are destined for Russia, the economy is estimated to have contracted 2 per cent in 1998, after growing modestly in 1997. In contrast, in Tajikistan, where only 8 per cent of exports are destined for Russia, GDP grew an estimated 3 per cent, up from 1.7 per cent in 1997. Many CIS countries with large natural resource sectors were already suffering from the global recession in commodity markets (especially oil and metals).

Ukraine shared many of the underlying structural weaknesses of its Russian neighbour and suffered similarly strong pressure on its currency, leading to a sharp depreciation against the US dollar in September 1998. The Ukrainian government was then forced to reschedule its domestic debt obligations. The Ukrainian economy contracted an estimated 1.5 per cent in 1998.

CIS countries continued to lag considerably behind CEE countries in implementing structural reforms (see the table on page 8). Fearing the employment repercussions and under pressure from vested interests, governments throughout the CIS region were unable or unwilling to advance corporate restructuring. Enterprises were kept afloat by arrears on inter-enterprise payments and taxes. The fiscal position of many countries in the region was also undermined by low tax collection. This in turn constrained investment in health and education, and in social programs for the poor.

Not all CIS countries, however, were equally affected. Those that had previously delayed reforms because of internal civil unrest or war, such as Armenia, Azerbaijan, Georgia and Tajikistan, began to make up lost ground in 1998 by adopting and initiating long-delayed reform programs to foster transition. Armenia, Azerbaijan and Tajikistan, as well as Kazakhstan, were able to sustain relatively stable exchange rates in the wake of the Russian crisis and, as a result, some of these economies experienced some disinflation. All of these countries were able to maintain positive growth in 1998, although in the cases of Kazakhstan and Georgia, the rate of growth slowed somewhat.

Impact of the Russian/Emerging Markets Crisis on the EBRD

The impact of the Russian crisis on the EBRD was direct and deep. As of December 31, 1998, 25.5 per cent of the EBRD's disbursed loan and equity portfolio was in Russia. Furthermore, nearly one-third of this exposure was to the Russian financial sector. The EBRD recorded its first annual loss since 1992 – ECU 261.2 million (C$468.3 million) – as it increased its provisions following an extensive review of the effect of the Russian crisis on the EBRD's

projects in Russia and other countries, particularly in the banking sector.[2] However, the strong capitalization of the Bank has allowed it to absorb the loss without threatening its financial viability.

The EBRD, as a regional development bank, however, has an inherently more risky portfolio than the World Bank or the International Finance Corporation because the EBRD's portfolio does not have as diversified a geographic distribution.

The EBRD responded to the Russian financial crisis by first taking steps to safeguard its existing investments and second, by moving to gradually rebuild investor confidence in the region. EBRD banking resources were significantly redirected from developing new projects to monitoring projects that saw a deterioration in their creditworthiness. This often included a hands-on approach by EBRD bankers in working with company management to overcome financial problems.

There was also a significant impact on the geographic focus of the EBRD's operations. In 1997 and early 1998, the EBRD came under strong criticism from some shareholders for not meeting its notional target of 30 per cent of new operational commitments in advanced transition economies. By the end of the 1998, however, the share of new commitments in advanced transition economies had risen to 40 per cent, while Russia's share had fallen to 23 per cent (from a business plan target of 30 per cent) and the share for early/intermediate countries had fallen to 37 per cent (from a target of 40 per cent). This shift reflected, in part, the greater difficulty some advanced transition economies had in accessing commercial financing, as well as a deterioration of the investment climate in Russia and early and intermediate transition countries. It also marked the beginning of a conscious effort on the part of the EBRD to rebalance its portfolio to offset the growing risks of Russian and CIS exposure.

Lessons Learned

An important lesson from the crisis is that the transition process will take longer than initially thought. The Russian financial crisis has vividly confirmed that transition countries that have moved forward most aggressively with structural reforms have been better able to weather the financial crisis than those countries where progress on restructuring has been slow and uneven. In particular, the crisis has demonstrated the importance of sound bankruptcy practices, transparent and effective tax regimes, strong regulatory and financial institutions, and effective legal frameworks that set good governance

[2] Provisions are substracted from operating income along with other expenses. For private sector projects, the bulk of the EBRD portfolio, provisioning follows a risk-based approach. Management continually reviews the portfolio to ensure that the currency value of loans and investments reflects management's best estimate of the recoverability of Bank assets.

standards and inhibit corruption. These are the fundamental prerequisites for building investor confidence and will take more time to develop in many transition countries than initially expected.

The crisis has underlined that the state has a pre-eminent role to play in building and consolidating the institutional and social basis for a healthy market economy. The state must have the capacity to enforce laws, collect taxes, regulate financial markets, promote enterprise restructuring and ensure effective corporate governance. However, in many countries, the way privatization was undertaken has created strong vested interests that compete with the state and limit its ability to undertake the most basic of functions, such as tax collection and law enforcement. This in turn further weakens the state, fuels corruption and stalls transition, particularly in such important areas as enterprise restructuring.

In addition, the crisis has underlined the significant social strains of the transition process, which were largely underestimated at the start of the process. The heavy industrial and environmental legacy of the central planning regime in many countries means that the transition process will entail heavy social costs in terms of unemployment and a low level of government services into the medium term. Therefore, many governments in the region face a significant challenge in building the social consensus essential for a successful transition.

The EBRD has traditionally been an active supporter of privatization efforts throughout the region and has provided support to locally owned privatized firms. However, in the wake of the Russian financial crisis, the Bank will participate in enterprise restructuring only with strong strategic partners with a proven track record in achieving change to ensure the risks and costs associated with such projects are minimized for the Bank.

Several years of experience in the region has shown that large state-owned firms that have been privatized through special management buyouts that preserve the control of planning-era management do not perform as well as newly established private firms (locally owned or majority foreign-owned). The pressures of the Russian and emerging markets financial crises have only reconfirmed this conclusion, as large enterprise owners with close contacts with state agencies have intensified their lobbying for the continuation of direct and indirect government support for their failing companies.

In 1998, in the wake of the Russian crisis, the management and the Board of Directors of the Bank started a review of the EBRD's operational priorities. The new operational priorities will be reviewed by the Bank's Governors at the Annual General Meeting in April 1999.

1998 FINANCIAL PICTURE

Financial Highlights

- The Bank suffered losses of ECU 261.2 million (C$468.3 million). This was mainly due to increased provisioning as a result of the Russian crisis.
- Provisioning charges totalled ECU 553.1 million (C$992.4 million) in 1998, more than three times their 1997 level.
- 1998 losses masked strong income growth. Operating income rose by 30 per cent to ECU 450.5 million (C$808.3 million) primarily due to the excellent returns from the sales of selected equity investments and strong growth in Treasury income; operating profit grew to ECU 291.8 million, more than 50 per cent higher than in 1997.
- Despite the difficult operating environment, the Bank signed new commitments of ECU 2.37 billion (C$4.25 billion), virtually in line with its business plan. This provided funding to 96 projects in 24 countries of operation. The share of commitments going to Russia and to early and intermediate countries was lower than planned, as the Russian crisis curtailed business opportunities in these countries in the latter half of the year.
- The EBRD's ability to mobilize additional financing increased in 1998. The Bank mobilized 3.2 ECU in additional financing for every ECU that it invested in 1998, compared to an average of 2.6 ECU since operations began in 1991.
- Equity investments represented 33 per cent of new commitments, well above the 22 per cent target in the business plan, as the Bank participated in a number of privatizations in advanced transition countries.
- Administrative expenses were well within budget, with no real increase recorded for the fifth consecutive year.

In 1998, the EBRD suffered its first loss since 1992, reflecting the need to provision against the increased risk of its portfolio. Provisioning charges totalled ECU 553.1 million in 1998, more than triple their 1997 level. This is largely due to the Russian crisis.

At the same time, it is important to note that the Bank did not write off any of its assets in 1998 as a result of the crisis (two write-offs did occur but were unrelated to events in the last quarter of 1998). Indeed, the portfolio has so far stood up quite well to the crisis. Although there have been some arrears on loans, they have been largely technical in nature, reflecting the difficulties businesses have had in accessing foreign currency to pay their obligations to the EBRD, rather than problems of insolvency and hence non-recoverability. It is also noteworthy that the EBRD was exempted from the moratorium on foreign debt payments introduced by the Russian government in August 1998.

Administrative Efficiency and Cost-Effectiveness

The EBRD's general administrative expenses, expressed in pounds sterling, were well within budget and slightly lower than those for 1997, reflecting continuing budgetary discipline and cost controls. As a result of the strength of sterling during 1998, however, the Bank's general administrative expenses, when expressed in ECU, were 6.1 million ECU (C$10.9 million) above the level of last year.

The Bank's efforts at productivity enhancement have been commendable. In 1998, productivity continued to increase as both commitments and projects under implementation rose sharply while costs remained flat. A simplified approval process and streamlined documentation for projects involving fewer resources were adopted in 1998 as part of the continuing commitment to zero-base budgeting.

Priorities in 1998

Private Sector Development

Canada has been a strong supporter of the private sector work of the Bank, recognizing that a strong private sector is key for the successful transition to a market economy. Of the projects signed in 1998, about 80 per cent were private sector operations, broadly consistent with 1997 and well above the 62 per cent ratio in 1994.

Of particular importance over the past year has been the Bank's continuing effort to promote small- and medium-sized enterprises (SMEs). Much of the Bank's support for SMEs is provided through financial intermediaries, as the relatively small size of individual SMEs means direct financing by the EBRD would impose high administrative costs on the Bank. At the end of 1998, the EBRD had provided close to ECU 2 billion (C$2.8 billion) to local banks principally to on-lend to SMEs. Lending to these enterprises represented 24 per cent of commitments. By enhancing the financing available to SMEs, the Bank has helped to nurture entrepreneurship and create employment.

The Private Sector Focus of the Bank

The EBRD Agreement requires that the Bank achieve at least a 60/40 ratio (the so-called "portfolio ratio") in its private/public sector activities, both globally and in individual countries.

The global portfolio ratio was satisfied in 1998, with 68 per cent of the Bank's cumulative outstanding commitments linked to private sector activities. Progress in reaching the individual country ratios, however, was mixed. At the end of 1998, the ratio was attained in only 8 of the Bank's 26 countries of operation.

The deadline for meeting the portfolio ratio requirement in individual countries of operation (i.e., five years after the approval of the Bank's first operation in that country) is nearing in a number of countries. The shortfall has been most evident in lower transition economies, where privatization has developed relatively slowly and where the Bank has often been active in developing public infrastructure critical to the development of a strong private sector. Many lower and intermediate transition economies still have relatively small and immature private sectors.

Nevertheless, the private sector share remains below 60 per cent in a number of high transition economies (primarily in the Baltics) where the private sector is dominated by companies that are often too small to be the focus of direct EBRD operations. For these countries, the Bank has established a plan of action as part of its country strategy. In most of these countries, progress was made in 1998 towards meeting the target ratio.

Activities in the Financial Sector

In 1998, notwithstanding the Russian financial crisis, the EBRD signed 72 more financial sector operations valued at ECU 867 million (C$1.6 billion), bringing total EBRD exposure to the financial sector region-wide to ECU 3.5 billion (C$6.3 billion). By the end of 1998, the EBRD held an equity stake in 51 banks in 22 transition countries. In most cases where the EBRD holds an equity stake in a local financial institution, it is represented on the supervisory board of the institution where it promotes management accountability, good corporate governance, sound banking practices and proper environmental reviews/procedures.

The EBRD signed its first financial sector project in Azerbaijan in 1998, and a second SME line of credit was concluded for Ukraine with disbursement for the credit line pending ratification by the Ukrainian Parliament. The Canadian International Development Agency (CIDA) is providing C$3 million in bilateral technical assistance funding in support of the EBRD's second SME financing facility for Ukraine. The funds will be used to finance technical assistance for Ukrainian commercial banks by qualified Canadian organizations.

The EBRD has been active in developing non-bank financial institutions, particularly investment funds. EBRD support for private equity funds in the region is growing. By the end of 1998, total capital mobilized for funds in which the EBRD participated was ECU 2.7 billion (C$4.8 billion). These equity funds have invested in over 500 companies throughout the region and have contributed to mobilizing total financing of ECU 4.6 billion (C$8.3 billion) for companies in the region. Among the funds supported by the EBRD are 28 post-privatization and regional venture funds. These funds make significant use of technical assistance provided by bilateral donors to assist companies in the privatization and immediate post-privatization periods.

Investments in and loans to local financial institutions are the main avenues for the EBRD to provide financing to SMEs. The Russia Small Business Fund has been an important vehicle for financial sector and SME development.

The Russia Small Business Fund

Established by the EBRD as a pilot project in 1993, following a request by the G-7, the Russia Small Business Fund (RSBF) is a US$300-million fund financed jointly by the EBRD, the G-7, the EU and Switzerland, for the promotion of small- and micro-enterprise lending in Russia. Canada, through CIDA, contributed US$8.1 million (C$11.3 million) to the program. The Fund operates by lending to local banks that then on-lend to local SMEs. The RSBF also has a technical assistance facility whereby partner Russian commercial banks receive assistance from western experts.

By 1998, the RSBF was operating through 13 Russian banks in 23 regions and numerous small towns across Russia, and its consistently very low arrears levels made it one of the EBRD's most successful projects. Over 23,000 loans had been made for a total of US$315 million. The RSBF model has been replicated by the EBRD in Moldova, Bosnia-Herzegovina, Kazakhstan and, most recently, within the Ukraine SME line of credit.

The Russian financial crisis in 1998, however, constrained most of the Russian banks participating in the Fund. To preserve the important work of the RSBF in supporting SME development, the EBRD has taken a two-pronged approach. First, in conjunction with strategic foreign investors, it has begun to examine creating a new bank to which the existing RSBF portfolio of insolvent partner banks would be transferred. Second, the EBRD would continue to work, even on a limited basis, with those partner banks that have been co-operating with it through the crisis and which are potentially solvent.

Environment

Despite the challenges faced by the Bank in responding to the financial crises in 1998, support for the environment, as part of the Bank's mandate to ensure sustainable long-term development in member countries, remained a key priority. The Bank is directed by its statutes to "promote in the full range of its activities environmentally sound and sustainable development." The EBRD applies environmental due diligence to all its investment and technical co-operation operations.

Countries at more advanced stages of transition, especially those seeking accession to the EU, are now channeling more resources into investments to improve environmental conditions. In addition, increased attention is being given to improving the provision of essential municipal services, such as district heating, water supply and urban transport, as the availability and quality of these services are critical to underpinning economic development.

In 1998, 11 environmental projects were signed with a total EBRD commitment of more than ECU 196 million (C$351.7 million). Forty-three environmental analyses, including five environmental impact assessments and twenty-five environmental audits, were conducted on projects approved by the Board of Directors in 1998.

Municipal and Environmental Infrastructure Policy

The adequate provision of basic public infrastructure and services is essential for the economic transition process. Poor quality and under-supply of municipal services, together with energy inefficiencies, have often limited productivity. The EBRD is pioneering operations in this area by financing projects with municipal governments. In June 1998, the Bank approved an operations policy for municipal and environmental infrastructure that emphasizes private sector involvement as well as the development of appropriate regulatory structures and energy efficiency.

The EBRD and Nuclear Safety

Canada and other G-7 countries have been working closely with the EBRD to improve nuclear safety in CEE countries and the former Soviet Union. To facilitate this work Canada has generously contributed to the Nuclear Safety Account (NSA), which the EBRD administers on behalf of the G-7 countries and other contributors. The NSA is used primarily for making essential safety improvements to older generation Soviet-built reactors as part of a comprehensive program for their early decommissioning. As of December 31, 1998, pledges to the NSA totalled ECU 289 million (C$518.6 million). Canada has contributed C$19.5 million.

On the G-7's behalf, the Bank has agreed to administer the US$760-million Chernobyl Shelter Fund for securing the sarcophagus around the destroyed (by nuclear accident) Unit VI reactor in Ukraine. The G-7 nations and the European Union have pledged US$391 million, of which Canada has pledged a contribution of US$20 million.

Canada also supports the use of the EBRD's own resources to finance the completion of Soviet-designed nuclear power plants up to Western safety standards. The EBRD applies strict conditions to this support. The completion of these plants must be a commercially viable and "least cost" solution to the country's future electricity requirements; the completed plants must fully comply with Western nuclear safety standards; and any resulting increase in nuclear power in upgraded facilities must be offset by the closure of other unsafe nuclear plants.

Addressing Corruption and Poor Governance

The transition countries, like most emerging economies, face significant challenges in improving transparency and governance. The EBRD's mandate assigns it an important role in addressing governance issues by permitting it to operate only in countries committed to applying the principles of multi-party democracy and pluralism. These principles, when effectively implemented, contribute to transparency in government policy making, act as a check on corruption and ensure an effective state. To underline their importance, the Bank has curtailed financing of public sector projects in countries where the government's commitment to the principles of multi-party democracy is weak. Canada fully supports this approach.

The EBRD seeks to improve governance and transparency largely through the projects it undertakes. Equity investments have been an important tool in this regard. The Bank's participation on the boards of directors of companies in which it invests has been instrumental in improving the transparency of their accounting and business practices and the respect of minority shareholder rights. It is hoped that the success of these companies will have important demonstration effects in the region. In addition, all Bank counterparties are examined to ensure they meet the highest standards of business practice.

In this regard, Canada was instrumental in tightening the Bank's public sector procurement rules against corrupt practices. The new rules underline for all doing business with the EBRD the standards of ethics and conduct required during the procurement and execution of EBRD-financed projects. In 1998, concerns expressed by many Directors about Bank co-investment with companies resident in offshore tax havens led to a review of this issue.

The Bank also attempts to influence the investment climate in its countries of operation through policy dialogue with government. An important high-level venue for this dialogue is the Foreign Investment Advisory Councils. They bring together government ministers, political leaders from the Bank's countries of operation, representatives of the international business community and high-ranking EBRD officials twice yearly to discuss how to improve the investment climate in the countries.

Institutional Developments

Changes in Presidency

In January 1998, Jacques de Larosière stepped down as President of the EBRD. The Bank's Governors elected Horst Köhler President effective September 1. Mr. Köhler joined the EBRD from the Association of German Savings Banks, where he served as President. This followed a distinguished career at the German Federal Finance Ministry where, from 1990 to 1993, he played a critical role in building western support for the transition process in Central and Eastern Europe.

President Köhler continues to uphold the project-centered private sector focus of the Bank. In addition, he has underlined that the Bank must strive harder to influence specific improvements in the institutions, the legislation and the key variables in the investment climate of its countries of operation. President Köhler has met numerous times with the heads of the World Bank, the International Monetary Fund and other regional development banks to intensify co-operation between institutions and build on their complementarities.

Introduction of the Euro

With the adoption of the Euro as the official currency of the European Monetary Union on January 1, 1999, the EBRD changed its reporting currency from the ECU to the Euro. This required modifications to the EBRD's processing and accounting systems. The Euro will enter into circulation on January 1, 2002. For the transition period, the EBRD has adopted a set of guiding principles for all relevant transactions and relationships with borrowers and counterparties with a view to maximizing flexibility for clients.

Year 2000 Compliance

In January 1998, EBRD management created a committee to develop a Bank-wide action plan for year 2000 (Y2K) compliance. All information technology systems in the EBRD have now been assessed and corrected to ensure that they are Y2K compliant. Testing is expected to be completed in March 1999. In addition, the Bank now includes Y2K resolutions in all its standard loan agreements.

Financial institutions face special challenges, however, in meeting the challenges of Y2K because of their numerous links with external parties – other financial institutions, exchanges, clearing houses and clients. Failure of these parties to be Y2K compliant can have financial implications for a fully compliant financial institution. To address this issue, the EBRD has identified potential high-risk clients and is working with them to reduce the risks.

Managing Canada's Interests

The highest authority in the Bank is the Board of Governors. Member countries are represented by a Governor and an Alternate Governor. The Honourable Paul Martin, Minister of Finance, is the Canadian Governor and Mr. Donald Campbell, Deputy Minister of Foreign Affairs, is the Alternate Governor.

The Board of Directors is responsible for the general operations of the Bank. The Board is composed of 23 members, of which four are non-European members. Canada is the third largest non-European shareholder, after the United States and Japan, and by virtue of its share has the right to elect its own Director. Canada also represents Morocco at the Bank. The Canadian Director is Mr. Patrice Muller. Mr. Tom MacDonald, Minister (Economic/Commercial) in the Canadian High Commission in London, is the non-resident Alternate Director who represents Canada in the absence of the Canadian Director.

Within the Canadian Government, responsibility for oversight of the EBRD's activities resides with the International Finance and Economic Analysis Division of the Department of Finance. In consultation with the Department of Foreign Affairs and International Trade (DFAIT) and CIDA, the Department of Finance regularly reviews the Bank's policy papers and proposed country strategies, and provides advice to the Canadian Director.

Canada continued to advocate increased EBRD activity in Ukraine and other countries in lower or intermediate stages of transition, provided the increased risk was balanced against lower risk projects elsewhere in the portfolio. Canada has supported the development within the Bank of a "wholesale" approach to activities, under which the Bank channels financing to SMEs

through lines of credit or equity investments in local banks and other financial intermediaries in its countries of operation. In light of the Russian crisis, Canada has encouraged the EBRD to pay greater attention to systemic risks in the financial sector and to improve co-ordination with other institutions, particularly the World Bank, in addressing issues of regulation and supervision.

Canada's Voting Record

Canada and other shareholders typically raise concerns and questions about specific Bank operations before they get to the Board. As a result, decisions at the Board are generally taken by consensus without a formal vote. Nevertheless, the Canadian Director voted against:

- a loan to Chernogorneft, a large privately owned Russian oil company, because of a longstanding commercial dispute between that company and a Canadian investor; and
- the financing of two steel projects in the FYR of Macedonia and Moldova because they were viewed as unlikely to be financially viable without significant displacement of production in other countries.

Canada has continued to underline the importance of the project-centered private sector focus of the EBRD. It has also argued that the Bank cannot relax its efforts to expand the share of its private sector operations. Recent events have, however, underlined the importance of the state and its institutions in private sector development. Canada has argued that the Bank must do more to influence the investment climate in its countries of operation through the demonstration effects of its projects, through its relationship with client governments and through consultation with other international financial institutions operating in the region. The Canadian Director has frequently spoken in the Board on the importance of the Bank's charter requirement that member countries be committed to market reform and multi-party democracy.

With respect to its own contributions to the EBRD, Canada continued to play a leading role in the adoption of zero real growth budgets for 1998. The Canadian Director chaired the EBRD Board's Budget and Administrative Affairs Committee, which sets the administrative budget levels and deliberates on the annual targets for the volume of financing operations.

Canadian Commercial Interests

The EBRD offers a wide variety of opportunities for Canadian businesses. One of the tasks of the Canadian Office is to make Canadian business people aware of investment opportunities, explain how the Bank's contracting works and ensure that all contracts are awarded in a transparent and fair manner.

To achieve these objectives, the Canadian office provides market information and intelligence to Canadian firms, advises Canadian project sponsors on EBRD financing options, develops commercial co-financing opportunities with the Export Development Corporation and Canadian financial institutions, identifies and sources EBRD procurement opportunities with DFAIT and Industry Canada, and promotes Canadian technical co-operation activities and official co-financing between the EBRD and CIDA.

In 1998, two Canadian-sponsored projects were signed and additional financing was approved for a third project, representing EBRD financial commitments of US$47.4 million. (The aggregate size of the three projects is US$243.4 million.) A description of each of the Canadian-sponsored projects is given in Annex 2.

Canadians are also well represented on EBRD staff. At the end of 1998, Canadians accounted for 5.3 per cent of the Bank's professional positions, above Canada's 3.4-per-cent share of the institution's capital. It is noteworthy that a Canadian heads the Bank's resident office in Kyiv and that Canadians are the deputy heads of the Poland/Czech and Slovak Republic/Baltics Team as well as the Bank's resident office in Kazakhstan.

Promoting Canada's Interests

Members of the Canadian office made six visits to Canada in 1998 to meet with business people, conduct seminars, speak at conferences and consult with government officials.

In addition, a Director's Assistant promoted the Canadian Office and the EBRD as instruments for advancing Canadian commercial interests to a Canadian trade mission travelling in the Baltic region.

Challenges Ahead

Most of the countries of the region have made significant progress in economic and political transition since the early 1990s. Throughout this process the EBRD has, both directly and through the demonstration effects of its projects, helped to advance the transition process. The Bank has been important in catalyzing private sector investment in the region and has been a strong force in promoting entrepreneurship, particularly through its support for SMEs.

The Russian crisis has served as a litmus test of the transition process, highlighting the challenges for the future. It has underlined the importance of an effective institutional framework for a well-functioning market economy. It has shown that those countries with strong institutions and good regulatory frameworks should be in a good position to continue to make progress in the transition process in the coming year. Those with weak underlying fundamentals, however, will remain extremely vulnerable to external shocks.

The countries in the region will be put to the test further in 1999 with the prospects for economic recovery in Russia, at this point, tenuous at best. Russian output continued to fall in early 1999 and although inflation has moderated somewhat, it remains at double-digit levels and well above its pre-crisis level. Those countries with the strongest links to Russia, particularly the CIS, continue to be threatened and will need to show an even stronger commitment to reforms to weather these difficulties.

Good governance will continue to play a critical role in these countries. Good corporate governance is one aspect of this. The state, however, also has a strong role to play in supporting an enabling investment climate, by promoting sound institutions, administering tax collection and improving legal and regulatory frameworks. It must also ensure that appropriate new legislation is not only developed, but is properly implemented.

In assisting its member countries in 1999, the EBRD in turn will face the challenge of managing its portfolio in an increasingly uncertain and risky environment. The Bank will need to pay increased attention to balancing its portfolio across countries, products and risk categories. The EBRD's medium-term strategy for 1999-2002 will be critical in ensuring the Bank has sufficient flexibility to meet new challenges in the coming years and in providing strong direction to the Bank in fulfilling its mandate.

A clear lesson from the crisis is that transition in the region is a complex and difficult process that will take longer than many initially expected. The primary responsibility for shaping a response to the challenges of transition lies with the countries themselves. The international financial institutions, however, particularly the EBRD, have an important supporting role to play.

Contacting the Office of the Director for Canada

The Canadian Director's Office at the EBRD may be reached at:

Office of the Director for Canada and Morocco
European Bank for Reconstruction and Development
One Exchange Square, Room 8.15
London, EC2A 2JN
United Kingdom

Mr. Patrice Muller, Director	Tel: 44-171-338-6457
Mr. Tom MacDonald, Alternate Director[1]	Tel: 44-171-338-6507
Ms. Josée Berthiaume, Director's Assistant[2]	Tel: 44-171-338-6458
Mr. John Kur, Director's Assistant[3]	Tel: 44-171-338-6509
Mrs. Diana Price, Executive Secretary	Tel: 44-171-338-6507
	Fax: 44-171-338-6062
	Internet address: PriceD@ebrd.com

[1] Resident at the Canadian High Commission in London.

[2] Responsible for policy matters.

[3] Responsible for business development and investor liaison.

For More Information on the EBRD

The Bank releases considerable information on its various activities. Bank publications include information guides (e.g., *Financing With the EBRD*), special reports (e.g., *The Annual Report, Transition Report*), country strategies and assorted fact sheets.

Information can also be obtained on the Bank's Internet site:

http://www.ebrd.com/

Requests for information can be addressed to:

Publications Desk
European Bank for Reconstruction and Development
One Exchange Square
London, EC2A 2JN
United Kingdom
(Fax: 44-171-338-7544)

ANNEX 1

THE BANK'S FINANCIAL ACTIVITIES

The Bank's financial activities are divided into ordinary and special operations depending on the source of funds. Ordinary operations, which are financed from the ordinary capital resources of the Bank, comprise subscribed capital, market borrowings and income from loans and investments. Special operations are those financed by "Special Funds" for specially designated purposes that are typically outside the Bank's regular activities. Unlike other regional development banks, however, the EBRD does not operate a concessional or "soft" loan window.

Ordinary Capital Resources

At the end of 1998, the total authorized capital of the Bank was ECU 20 billion (about C$35 billion). Canada has subscribed to 3.4 per cent – or ECU 680 million (about C$1.2 billion) – of the Bank's authorized capital. Canadian contributions to the Bank's capital are made in US dollars (at a pre-determined ECU/US$ exchange rate).

In 1998, Canada made its first purchase of shares under the first capital increase (which came into effect April 3, 1997 and doubled the initial ECU 10-billion capital base). Under the first capital increase, 77.5 per cent of our share is "callable" – i.e., the Bank can request these resources in the unlikely event that it requires them to meet its financial obligations to bondholders; the balance, or 22.5 per cent, is "paid-in." Payments will be made in eight equal annual instalments of US$12,145,331.25 (40 per cent in cash and 60 per cent in non-interest-bearing demand notes encashed over five years). Under the initial capital, 30 per cent was paid-in over five years (split evenly between cash and notes encashed over a three-year period) and 70 per cent callable. Canada completed payments for the initial capital in April 1997. The table below details Canadian payments to the Bank in US dollars.

Canada's contributions to the capital of the Bank are non-budgetary expenditures because our shares in the Bank are considered an asset. Nonetheless, Canada's contributions to the Bank do increase the government's borrowing requirements.

Canadian Payments to the EBRD

Year	Notes	Cash	Encashment of notes	Total cash outlay
		(in US dollars)		
1991	11,903,502	11,903,502	11,903,502	23,807,004
1992	11,903,502	11,903,502	3,967,834	15,871,336
1993	11,903,502	11,903,502	7,935,668	19,839,170
1994	11,903,502	11,903,502	11,903,502	23,807,004
1995	11,903,502	11,903,502	11,903,502	23,807,004
1996	-	-	7,935,668	7,935,668
1997	-	-	3,967,334	3,967,334
1998	7,287,198	4,858,132	1,457,439	6,315,572
Total	66,804,708	64,375,642	60,974,449	125,350,092

Market Borrowings

At the end of 1998, cumulative borrowings by the Bank totalled ECU 9.7 billion (C$17.4 billion) with an average maturity of 7.1 years at an average cost of funds of LIBOR minus 37 basis points. Funds have been swapped into floating rate instruments, primarily in US dollars, ECU and deutschmarks.

Standard & Poor's has assigned the Bank an AAA long-term and A-1+ short-term credit rating. Moody's Investors Service has similarly rated the EBRD long-term bonds triple-A.

Special Operations

The EBRD administers a number of bilateral and multilateral concessional funds. Canada has contributed to the following Special Funds:

The Canada Technical Co-operation Fund – The main purpose of this fund is to provide financing to hire Canadian consultants for EBRD projects. Canada has contributed C$7.66 million since the Fund was established in 1992.

Nuclear Safety Account (NSA) – This facility was established to help finance the closure of the Chernobyl nuclear power plant and to improve safety conditions at nuclear power plants in countries of operation until the plants can be closed. The NSA complements other bilateral and multilateral nuclear safety technical assistance and functions in parallel with multilateral efforts to achieve broader energy sector reform in the region. Canada has contributed C$19.5 million to the total fund of ECU 289 million (C$518.6 million). The NSA was established in 1993.

Chernobyl Shelter Fund – The main purpose of this fund is to secure the sarcophagus around the destroyed Unit VI nuclear reactor in Ukraine. The total estimated cost of this eight-year project is US$758 million and US$391 million has been pledged so far. Canada has pledged a contribution of US$20 million to be paid over six years starting in 1998.

Russia Small Business Fund (RSBF) – The purpose of this fund is to establish a facility for small business finance and micro-lending in various regions of Russia. Canada has contributed US$8.1 million toward the US$300-million fund, including a new contribution of US$2 million in 1998 for investments in northern Russia in response to the success of the Fund. The RSBF was established in 1993 as a pilot project and became permanent in 1995.

Annex 2

EBRD – Canadian-Sponsored Project Activity in 1998

Approval/ signing date	Canadian company	Project country	Project name	Type of financing	Total EBRD commitment (ECU million)	Total project cost US$ million
February (signed)	Consumers Packaging Inc.	Ukraine	AD Zarya Glass	Equity	12.4	48.8
November (signed)	Saskatchewan Wheat Pool Strait Crossing Inc. and Dessaport International	Poland	Europort Gdansk Grain Terminal	Senior debt[1]	25.0	86.6
November (approved)	Telesystem International Wireless Corporation	Romania	MobiFon GSM Phase II Financing	Senior debt[2]	10.0	108.0
Total					**47.4**	**243.4**

[1] The EBRD provided US$25 million in senior debt from its own account in addition to US$25.5 million in syndicated loans and US$14.5 million in parallel loans, of which Export Development Corporation (EDC) provided US$7 million. The Royal Bank of Canada underwrote US$32.5 million of the financing and took a final participation of US$7.5 million.

[2] For the project's Phase I Financing, the EBRD signed a senior loan of US$85 million and a subordinated loan of US$10 million with MobiFon on September 23, 1997. EDC also provided a parallel loan of US$25 million. For the project's Phase II Financing, the EBRD provided US$10 million in senior debt from its own account in addition to US$10 million in syndicated loans. EDC provided a further US$10 million in parallel co-financing in Phase II.

Annex 3

Doing Business With the EBRD

General inquiries about working with the EBRD should be directed to the Office of the Director for Canada or to the Bank's **Communications Department** in London – (tel: 44-171-338-6096; fax: 44-171-448-6690).

Canadian Project Sponsors: Canadian companies interested in potentially sponsoring a project with the EBRD are requested to direct initial inquiries either to **Project Inquiries** in London (tel: 44-171-338-6282 or 44-171-338-6252; fax: 44-171-338-6102) in London or to the Bank's Resident Office in the country of operation. Summaries of EBRD private sector operations can be obtained on the Bank's Internet site: http://www.ebrd.com/ .

Canadian Suppliers of Goods and Works: In its monthly newsletter, *Procurement Opportunities,* the EBRD makes available information on all stages of public sector project development, from the point a project has been identified by the Bank through to its approval. Procurement and co-financing notices, as well as and contract awards information, isare also published in the newsletter. *Procurement Opportunities* can be accessed on the Bank's Internet site (assee addressed above), and a hard-copy subscription can be obtained for £85 from:

> EBRD Subscription Department (*Procurement Opportunities*)
> 82-84 Peckham Rye
> London SE15 4HB
> United Kingdom
> Tel: 44-171-639-0333
> Fax: 44-171-358-9568

Canadian Consultants: The EBRD's *Procurement Opportunities* newsletter contains technical co-operation notifications, and invitations for expressions of interest for consultancy services, pertaining to both public and private sector projects. The EBRD also makes use of the World Bank's electronic DACON (Data on Consultants) Registration System. Although it is not required for consultants to register with DACON to be eligible for EBRD assignments, it is nonetheless advisable as a useful marketing tool. Requests for DACON registration packages should be sent directly to:

> DACON Information Centre
> World Bank
> 1818 H Street
> Washington, DC 20433 USA

Individual Canadians: The EBRD maintains a recruitment section on its Internet site, which provides information on specific employment competitions at the Bank as they become available. In general, applications for employment for both permanent positions and summer jobs should be sent to:

Mr. Franco Furno, Director of Personnel
Personnel Department
European Bank for Reconstruction and Development
One Exchange Square
London, EC2A 2JN
United Kingdom

ANNEX 4

EBRD MEMBERSHIP – AS AT DECEMBER 31, 1998

	Share of the Bank's capital (%)
European Members	
Austria	2.28
Belgium	2.28
Cyprus	0.10
Denmark	1.20
Finland	1.25
France	8.52
Germany	8.52
Greece	0.65
Iceland	0.10
Ireland	0.30
Israel	0.65
Italy	8.52
Liechtenstein	0.02
Luxembourg	0.20
Malta	0.01
Netherlands	2.48
Norway	1.25
Portugal	0.42
Spain	1.70
Sweden	2.28
Switzerland	2.28
Turkey	1.15
United Kingdom	8.52
European Union	3.00
European Investment Bank	3.00
Non-European Members	
Australia	0.50
Canada	**3.40**
Egypt	0.10
Japan	8.52
Korea	1.00
Mexico	0.15
Morocco	0.05
New Zealand	0.05
United States	10.00

	Share of the Bank's capital (%)
Countries of Operation	
Albania	0.10
Armenia	0.05
Azerbaijan	0.05
Belarus	0.20
Bosnia and Herzegovina	0.17
Bulgaria	0.79
Croatia	0.36
Czech Republic	0.85
Estonia	0.10
FYR of Macedonia	0.07
Georgia	0.10
Hungary	0.79
Kazakhstan	0.23
Kyrgyzstan	0.10
Latvia	0.10
Lithuania	0.10
Moldova	0.10
Poland	1.28
Romania	0.48
Russian Federation	4.00
Slovak Republic	0.43
Slovenia	0.21
Tajikistan	0.10
Turkmenistan	0.01
Ukraine	0.80
Uzbekistan	0.21

Report on Operations Under the European Bank for Reconstruction and Development Agreement Act

1999

Canada

Report on Operations Under the European Bank for Reconstruction and Development Agreement Act

1999

Prepared by:
International Trade and Finance Branch
March 2000

Department of Finance Canada | Ministère des Finances Canada

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Ottawa, Ontario, Canada K1A 0G5
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http://www.fin.gc.ca/

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Introduction

The European Bank for Reconstruction and Development (referred to in this document as the EBRD or the Bank) was established in 1991. Its aim is to foster the transition towards open, market-oriented economies in Central and Eastern Europe, as well as in the successor states of the Soviet Union, and to promote private and entrepreneurial initiative in countries in this region that are committed to the fundamental principles of multi-party democracy, pluralism and a market economy (see Annex 4 for a list of the EBRD's 26 countries of operation).

The EBRD functions as a development bank, much in the same way that the World Bank and other regional development banks operate. The EBRD, however, is distinctive in three areas. First, its overriding focus is on the private sector and support for the transition from central planning to stable market economies. Its Charter stipulates that not less than 60 per cent of its financing commitments should be directed either to private sector enterprises or to state-owned enterprises implementing a program to achieve private ownership and control. Second, the EBRD's mandate gives it a particular focus on the promotion of democratic institutions and human rights in its countries of operation. Finally, the EBRD is explicitly committed under its Articles of Agreement to ensuring the environmental sustainability of all its projects.

The Bank seeks to help its 26 countries of operation to implement structural and sectoral economic reforms, taking into account the particular needs of countries at different stages in the transition process. In particular, its private sector activities focus mainly on enterprise restructuring, including the strengthening of financial institutions, and the development of infrastructure needed to support the private sector. The EBRD has 60 members: 58 countries, the European Union (EU) and the European Investment Bank (see Annex 4 for a list of the members).

Canada is the eighth largest shareholder (tied with Spain) and following the other Group of Seven (G-7) countries and the Russian Federation. Our formal participation is authorized under the European Bank for Reconstruction and Development Agreement Act, which was promulgated in February 1991. Article 7 of the Act states that:

> The Minister [of Finance] shall cause to be laid before each House of Parliament by March 31 of each year, or if that House is not then sitting, on any of the thirty days next thereafter that it is sitting, a report of operations for the previous calendar year, containing a general summary of all actions taken under the authority of this Act, including their sustainable development aspects within the meaning of Article 2 of the Agreement, and their human rights aspects.

This report responds to this requirement and reviews the activities and operations of the Bank for the year 1999.

BENEFITS OF MEMBERSHIP

As a major trading nation, Canada has a stake in global peace and stability. The successful integration of Central and Eastern Europe and the former Soviet Union into the world economy and global institutions will help to promote peace and stability. The EBRD, by fostering continued economic reform in the region, is contributing to the region's integration into the world economy.

EBRD membership provides a number of specific benefits:

- The Minister of Finance is a Governor of the Bank and elects an Executive Director to its 23-member Board of Directors. This representation allows Canada to have high-level influence on decisions taken by the EBRD on investments in the region and policies to move forward regional development.
- The EBRD provides trade opportunities for the Canadian private sector and allows a diversification of international markets for Canadian business.

ROLE AND MANDATE OF THE EBRD

The EBRD:

- fosters the transition of former centrally planned economies of Central and Eastern Europe and the Commonwealth of Independent States towards market-oriented economies;
- promotes private entrepreneurial initiative (targets at least 60 per cent of its resources to private sector projects with the balance in support of commercially viable state sector projects that promote private sector development);
- operates only in countries committed to applying the principles of multi-party democracy, pluralism and market economics;
- promotes environmentally sound and sustainable development; and
- operates on a self-financing basis.

The EBRD's operations to advance the transition to a market economy are guided by three principles: maximizing transition impact, additionality and sound banking. Financing is provided for projects that expand and improve markets, help build the institutions necessary for underpinning the market economy, and demonstrate and promote market-oriented skills and sound business practices. EBRD financing must also be additional to other sources of financing, and not displace them, further ensuring the Bank contributes to the transition process. Finally, Bank projects must be sound from a banking perspective, thus demonstrating to private investors that the region offers sound returns. Adherence to the sound banking principle also helps ensure the financial viability of the EBRD and hence its attractiveness as a co-investment partner for the private sector.

In promoting economic transition in its countries of operation, the Bank acts as a catalyst for increased flows of financing to the private sector. The capital requirements of these countries cannot be fully met by official multilateral and bilateral sources of financing, and many foreign private investors remain hesitant to invest in the region. By providing an umbrella under which wider funding for private sector investment can be assembled, the EBRD plays a catalytic role in mobilizing capital. In 1999, for every euro the EBRD invested, it mobilized an additional 2.2 euro from the private sector and multilateral and bilateral agencies.[1]

Indeed, the projects of the Bank serve a dual purpose. They are intended not only to directly support the transition from a command to a market economy in countries of operation, but also to create a demonstration effect to attract foreign and domestic investors. Like the World Bank Group's International Finance Corporation, the Bank is required to operate on a strictly commercial basis and to attract companies to invest in countries through financially viable projects, not through subsidies.

[1] On January 1, 1999, the euro replaced the ECU as a market-determined currency in the euro-zone's 11 member countries participating in the Economic and Monetary Union. On December 31, 1999, one euro purchased 1.4556 Canadian dollars.

Key Developments in 1999

The year 1999 was a challenging one for the EBRD not only in Russia itself, but throughout the Commonwealth of Independent States (CIS),[2] as well as in some Central and Eastern European countries with strong economic links to Russia. The impact of the Russian financial crisis, which erupted in August 1998, continued to dampen investor confidence and business activity into 1999. Investor confidence suffered an additional shock in March 1999 with NATO military intervention in Kosovo.[3] The economies of southeastern Europe were affected to varying degrees by disruptions in trade routes and by the movement of large numbers of refugees caused by the Kosovo crisis. The EBRD estimates the Kosovo crisis reduced 1999 real gross domestic product (GDP) growth by about one percentage point in the six affected neighbouring countries – Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the Former Yugoslav Republic (FYR) of Macedonia and Romania.

Nonetheless, by mid-1999, economic performance showed signs of improvement throughout the EBRD's countries of operation. Rising commodity prices, particularly oil prices, eased balance of payments pressures in Russia and contributed to growth in commodity-exporting CIS countries, while the end of military action in Kosovo improved prospects in southeastern Europe. However, deep-rooted structural problems remain in many of the transition economies, notably in Russia and elsewhere in the CIS, and in southeastern Europe. The absence of significant progress in structural reforms, as evidenced by state tolerance of tax arrears, the culture of non-payment, and lack of effective bankruptcy legislation, leaves these economies more vulnerable to future internal or external shocks. In many countries, the investment climate remains uninviting as powerful vested interests foster a culture of corruption and regulation that stifles competition.

The economic developments of the last year only reinforce the conclusions drawn from a decade of transition. Countries (principally in Central and Eastern Europe) that have been most committed to reform and have moved the furthest in creating strong state and corporate institutions proved best able to weather the financial turbulence of 1998. They continued to make good progress through 1999. The following table ranks transition countries according to a number of indicators.

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[2] The CIS includes Russia and the other successor states of the Soviet Union.

[3] Kosovo is a province of the Federal Republic of Yugoslavia (FRY). FRY, and by extension Kosovo, is not a member of the Bank.

Progress in Transition in Central and Eastern Europe and the CIS[1]

Countries	Population (millions, mid-1999)	Private sector share of GDP in %, mid-1999 (EBRD estimate)	Enterprises: Large-scale privatization	Enterprises: Small-scale privatization	Enterprises: Governance and enterprise restructuring	Market and trade: Price liberal-ization	Market and trade: Trade and foreign exchange system	Market and trade: Compe-tition policy	Financial institutions: Banking reform and interest rate liberalization	Financial institutions: Securities markets and non-bank financial institutions
Albania	3.2	75	2	4	2	3	4	2	2	2-
Armenia	3.7	60	3	3+	2	3	4	2	2+	2
Azerbaijan	7.6	45	2-	3	2	3	3+	1	2	2-
Belarus	10.2	20	1	2	1	2-	1	2	1	2
Bosnia and Herzegovina	4.3	35	2	2	2-	3	3-	1	2+	1
Bulgaria	8.2	60	3	3+	2+	3	4+	2	3-	2
Croatia	4.5	60	3	4+	3-	3	4	2	3	2+
Czech Republic	10.3	80	4	4+	3	3	4+	3	3+	3
Estonia	1.4	75	4	4+	3	3	4	3-	4-	3
FYR Macedonia	2.0	55	3	4	2	3	4	1	3	2-
Georgia	5.4	60	3+	4	2	3	4	2	2+	1
Hungary	10.1	80	4	4+	3+	3+	4+	3	4	3+
Kazakhstan	14.8	55	3	4	2	3	3	2	2+	2
Kyrgyzstan	4.8	60	3	4	2	3	4	2	2+	2
Latvia	2.4	65	3	4	3-	3	4+	3-	3	2+
Lithuania	3.7	70	3	4+	3-	3	4	2+	3	3-
Moldova	4.3	45	3	3+	2	3	4	2	2+	2
Poland	38.8	65	3+	4+	3	3+	4+	3	3+	3+
Romania	22.4	60	3-	4-	2	3	4	2	3-	2
Russian Federation	146.7	70	3+	4	2-	3-	2+	2+	2-	2-
Slovak Republic	5.4	75	4	4+	3	3	4+	3	3-	2+
Slovenia	2.0	55	3+	4+	3-	3	4+	2	3+	3
Tajikistan	6.2	30	2+	3	2-	3	3-	1	1	1
Turkmenistan	4.9	25	2-	2	2-	2	1	1	1	1
Ukraine	50.7	55	2+	3+	2	3	3	2	2	2
Uzbekistan	24.2	45	3-	3	2	2	1	2	2-	2

Source: EBRD, *Transition Report – 1999.*

[1] The classification of transition indicators uses a scale from 1 to 4 where 1 implies little or no progress with reform and 4 implies a market economy. Most advanced industrial economies would qualify for the 4+ rating for almost all the transition indicators.

Highlights of Macroeconomic Performance

- Real GDP is expected to show a modest increase in 1999 for the region as a whole, after declining an estimated 1.2 per cent in 1998. The stronger performance was due to the better-than-anticipated performance of the CIS, largely as a result of the recovery in world commodity prices in 1999.
- Central and Eastern Europe continued to post a substantially better inflation performance than the countries of the CIS, though the CIS performed better than expected in the wake of significant exchange rate depreciation.
- A large number of countries, particularly in the CIS, continued to run current account deficits in excess of 7 per cent of GDP, raising doubts about their ability to service future liabilities.

Russia

The 1998 financial crisis exposed the fundamental weakness of the Russian banking system.[4] Economic activity collapsed as real incomes declined owing to accelerating inflation following the ruble devaluation, and investor and consumer confidence evaporated as the government struggled to articulate an effective recovery program for months after the onset of the crisis. However, from mid-1999 Russia experienced a surprisingly strong economic rebound, as the substitution of domestic for foreign goods following the ruble devaluation fuelled domestic production, and higher oil prices contributed to increasing government revenues and a substantially improved balance-of-payments position. The EBRD estimates real GDP grew 1.5 per cent in 1999, the highest growth rate since the beginning of transition, following a 4.5 per cent decline in 1998. The inflation rate stood at 37 per cent at the end of 1999, less than half the 1998 rate. The fiscal deficit is expected to be below the 5.1 per cent of GDP targeted in Russia's International Monetary Fund (IMF) program, agreed to in July 1999 but currently on hold. The Russian government's failure to meet IMF loan conditions has led to a suspension of disbursements.

Despite the dramatic macroeconomic adjustment in 1998 and signs of modest recovery and growth in 1999, the Russian economy remains vulnerable to external and internal shocks. The improvement in Russia's economic and fiscal performance is largely the result of positive developments

[4] The 1998 financial crisis was precipitated by the Russian government's decision on August 17, 1998, to respond to the escalating cost of debt financing and pressure on the ruble by suspending payments on its ruble-denominated debt obligations, announcing a moratorium on foreign debt payments and effectively devaluing the ruble. Many Russian commercial banks were heavily exposed to the Russian government and had considerable unhedged foreign exchange liabilities. As a result they were severely affected by the default and devaluation, and many collapsed.

in the external environment, particularly the recent strengthening of world oil prices, rather than economic reforms and restructuring. There has been little policy action to curtail tax arrears (although higher oil prices have increased state budget revenues and, since the second quarter of 1999, federal revenues have been entirely in money, as opposed to barter, tax offsets and other money surrogates) and bankruptcy laws remain ineffective. Similarly, little has been done to strengthen Russia's financial system. Financial institutions remain under-capitalized and poorly regulated. Efforts to reform the financial sector – through the creation of a bank restructuring agency (ARCO) and enactment of laws on the insolvency of credit institutions – have been largely undermined by the lack of regulatory enforcement by the central bank. Not surprisingly, investor confidence remains low. Foreign investment in Russia (gross foreign direct investment plus portfolio investment) sank more than 30 per cent in the first nine months of 1999. Capital flight continues, at about US$20 billion in 1999, according to the Institute of International Finance, indicating that the domestic Russian business community also has little confidence in the Russian economy.

Central and Eastern Europe

Within Central and Eastern Europe and the Baltic States (CEE) the overall economic picture is more encouraging. These economies showed considerable resilience to the Russian financial crisis. There was, however, significant variation across countries. Annual growth rates in Hungary and Poland remained strong at around 4 per cent in 1999, though down from a year ago owing to business cycle effects. In the Czech Republic growth is expected to show another year of decline, reflecting the slow response of the government to the domestic financial crisis in 1997. The recession appears to have bottomed out in the second quarter of 1999. In the Baltic States, growth slowed substantially in the first half of the year, reflecting the closer commercial ties of the countries to the Russian economy.

The stronger macroeconomic position of many countries of Central and Eastern Europe has been fostered by significant gains in competitiveness through successful enterprise restructuring and by the creation of strong market-supporting institutions (fiscal, legal, financial and social). Poland and Hungary in particular have advanced significantly in the transition process (see table on page 9) and appear well poised for long-term sustained economic growth.

Southeastern Europe

All the countries of southeastern Europe affected by the Kosovo conflict – Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FYR Macedonia and Romania – were able to maintain macroeconomic stability and a number, including Bosnia and Herzegovina, Bulgaria and Romania, continued to push forward with long-delayed structural reforms. Growth was particularly strong

in Albania and Bosnia and Herzegovina (8 and 10 per cent respectively), reflecting their low starting points. In Romania, the recession that began in 1997 appears to have bottomed out.

Despite the progress to date, southeastern Europe faces significant challenges in the future, principally as a result of its past uneven commitment to reform rather than the crisis in Kosovo. In many countries, the privatization process is incomplete, and loss-making enterprises and banks continue to operate and accumulate tax arrears, weakening governance. Progress in establishing the legal and social institutions that underpin effective markets and set the ground for private investment has been limited to date.

Accession to the European Union

The expectation of accession to the European Union (EU) has been an important factor strengthening financial stability and underlying economic reform efforts in Central and Eastern Europe. In December 1997, the EU, at its intergovernmental Council meeting, identified 10 "accession countries" as candidates for early membership and in March 1998 began initial accession negotiations with 5 (the Czech Republic, Estonia, Hungary, Poland and Slovenia).[1] In December 1999, at the Helsinki Summit, the EU decided to initiate accession negotiations with the remaining 5 accession countries (Bulgaria, Latvia, Lithuania, Romania and the Slovak Republic), with progress through the negotiations as quickly as warranted by each country's own efforts to prepare for accession. In addition, the Summit committed the EU to be ready to decide from the end of 2002 on the accession of candidates that fulfill all necessary criteria.

The EBRD, European Commission and World Bank have signed a memorandum of understanding setting out the basic principles for collaboration in supporting projects that will assist all accession countries in meeting the requirements of EU. In particular, all 10 accession countries face specific requirements for investment in infrastructure to meet the requirements of the EU's *Acquis Communautaire*, or inventory of laws and standards. The EBRD will actively support projects where its mandate and EU accession requirements overlap.

[1] The 10 accession countries are Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia. The EU has negotiated accession partnerships with all 10 countries.

The Non-Russian CIS

The effects of the 1998 Russian financial crisis continued to be felt throughout the non-Russian CIS region in 1999. In general, these economies were most affected by the financial crisis because they share many of the key problems of the Russian economy (such as a weak financial sector) and because of their close links to the Russian economy. In the first half of 1999, growth rates slowed considerably in most non-Russian CIS countries while recovery was delayed in others. However, only Ukraine and Moldova saw output decline. As Russia recovered and world commodity prices began to move higher in the second half of the year, growth in the non-Russian CIS strengthened. In particular, all the central Asian republics are estimated to have recorded growth in 1999 for the first time since the beginning of the transition process.

Ukraine was one of the countries most affected by the Russian financial crisis. As a result, real GDP is expected to have declined further in 1999, leaving Ukraine as the only country in the CIS not to experience economic growth in the 1990s. Progress on implementing reforms in 1999 was further delayed in the lead-up to the presidential elections in November. These delays led the IMF to put its program for Ukraine on hold. Since his re-election, President Kuchma has appointed Vicktor Yushchenko – the reform-minded and highly respected former Governor of Ukraine's central bank – as Prime Minister, raising hopes that long-delayed reforms will be implemented. The fractious pro-reform elements in parliament formed a united front early in 2000, which could make implementing reform efforts easier for the government, provided the coalition holds together.

Like Russia, the non-Russian CIS countries face significant challenges in terms of their communist legacy and the extent of structural distortions and the limited capacity of state institutions. CIS countries continue to lag considerably behind CEE countries in implementing structural reforms (see table on page 9). Nonetheless, difficult structural reforms have begun in a number of countries, notably Azerbaijan and Georgia, and they have now experienced a few years of growth. In 1999, Georgia, Armenia and Moldova strengthened structural reform efforts. In other countries, notably Belarus, Turkmenistan and Uzbekistan, there were reform reversals.

1999 Financial Picture

Financial Highlights

- The Bank posted a profit of 42.7 million euro (C$62.2 million) in 1999 following a significant loss of 261.2 million euro (C$468.3 million) in 1998, when it provisioned heavily against potential losses from the Russian crisis.[1]
- In 1999, provisioning charges totalled 160.9 million euro, down substantially from the record 553.1 million euro (C$992.4 million) in 1998.
- Operating income was 376.4 million euro, down from 450.5 million euro in 1998, primarily due to lower levels of dividend income, net fee and commission income, lower profits from the sale of share investments (although well above budget) as well as lower interest income due to non-performing loans.
- Despite the difficult operating environment, the Bank signed new commitments of 2.2 billion euro (C$3.2 billion) in 1999, just below the record of 2.4 billion euro in 1998 and virtually in line with the 1999 business plan. This provided funding to 88 projects.
- The share of new commitments going to Russia declined significantly in 1999, to 217 million euro (10 per cent of total) from 546 million euro in 1998 and a peak of 761 million euro in 1997, reflecting the weak investment climate in Russia. Nonetheless, Russia's share of the Bank's total disbursed portfolio remained substantial at 23.3 per cent at the end of 1999, though down from a peak of over 25 per cent in the third quarter of 1998. Early and intermediate transition countries[2] accounted for 48 per cent of new commitments and advanced transition countries 42 per cent in 1999.
- The Bank mobilized 2.2 euro in additional financing for every euro that it invested in 1999, down significantly from an exceptionally high ratio of 3.5 in 1998, as investor interest in the region waned. The average mobilization ratio since operations began in 1991 is 2.5.
- Equity investments represented 31 per cent of new commitments as the EBRD participated in a number of bank privatizations.
- Administrative expenses were well within budget, with zero nominal growth recorded in 1999.

[1] Provisions are subtracted from operating income along with other expenses. For private sector projects, the bulk of the EBRD portfolio, provisioning follows a risk-based approach. Management continually reviews the portfolio to ensure that the current value of loans and investments reflects management's best estimate of the recoverability of Bank assets.

[2] Advanced transition countries include Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic and Slovenia. The early and intermediate transition countries include the balance of the EBRD's countries of operation, excluding Russia: Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, FYR Macedonia, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Romania, Tajikistan, Turkmenistan, Ukraine and Uzbekistan.

The return to profitability at the EBRD in 1999 is encouraging. Strong portfolio monitoring, significant efforts to restructure problem investments, as well as a careful review of the committed but undisbursed portfolio helped put the EBRD back in the black. Nonetheless, the financial position of the Bank remains vulnerable. The loss in 1998 eliminated the Bank's reserves and surpluses (shareholder capital and retained earnings set aside to protect the Bank from unanticipated losses). Only by generating net income after provisions will the EBRD be able to rebuild its reserves and surpluses and increase its capital base and future risk-bearing capacity. This is especially important as shareholders provided a capital increase in 1996 on the understanding that there would be no further need for capital replenishments.

The impact of the 1998 Russian financial crisis on the EBRD's portfolio has likely been fully felt. Impaired assets, non-accruing loans and impaired equity peaked in the third quarter of 1999. At the end of 1999, they stood at 795 million euro, or about 11 per cent of the disbursed portfolio, up substantially from 519 million euro, or 7.6 per cent of the disbursed portfolio at the end of 1998, and under 4 per cent of the disbursed portfolio at the end of 1997, underlining the significant impact the crisis has had on the Bank's assets. Progress was made throughout 1999 in resolving a large number of problem loan investments in Russia, although the Bank did not reach the point where it was ready to lower outstanding provisions.

The EBRD wrote off six investments totalling 8.9 million euro over the course of 1999, including three in Russia and one each in Ukraine, Estonia and Hungary. The Bank made the decision to write off the investments only after exhausting all reasonable avenues to recover outstanding amounts. Two of the Russian exposures were to the Russia Small Business Fund[5] borrowers that were already in difficulty prior to the outbreak of the crisis. All the write-offs were at least partly provisioned.

Administrative Efficiency and Cost-Effectiveness

The EBRD's general administrative expenses in 1999 expressed in pounds sterling were well within budget and comparable to those for 1998, reflecting continuing budgetary discipline and cost controls. As a result of the strengthening of sterling against the euro during the year, the Bank's general administrative expenses, when expressed in euro, were 172.8 million euro (C$251.5 million), or 8.9 per cent above the 1998 level of last year.

The Bank's efforts at productivity enhancement have been commendable. In 1999, productivity continued to increase as both commitments and projects under implementation rose while costs (in £) remained flat. This achievement is

[5] In 1995, the G-7 committed US$150 million to the US$300 million Russia Small Business Fund. The G-7 contribution was split between an investment fund, which assumed a "first loss" position, and a technical assistance fund. Canada's contribution was for both funds.

particularly impressive, given the increased resource demands stemming from the need for greater portfolio monitoring and asset restructuring due to the credit deterioration in many of the Bank's countries of operation.

Medium-Term Operational Priorities Revised

In early 1999, largely in reaction to the Russian financial crisis, the EBRD developed revised operational priorities for the medium term that were outlined in the paper *Moving Transition Forward*. Governors endorsed the paper at the annual general meeting in April 1999 in London. The new priorities outlined in the paper are the result of a fundamental review of Bank operations and an assessment of the lessons learned from 10 years of experience working with countries in transition, as well as from the Russian crisis.

This review identified the creation of a sound institutional and policy environment to encourage investment and private sector development as the key challenge for the next decade. Thus, the main thrust of the revised operational priorities is ensuring that Bank projects contribute to strengthening the institutions that underpin a market economy. To achieve this objective, the Bank has identified six areas of focus:

- developing sound financial sectors linked to the needs of enterprises and households;
- providing leadership for the development of small and medium-sized enterprises;
- developing market-based and commercially oriented infrastructure;
- demonstrating, through selected examples, effective approaches to restructuring viable large enterprises;
- taking an active approach to equity investment to improve corporate governance; and
- engaging governments in policy dialogue to strengthen institutions and improve the investment climate.

The medium-term priorities underline that opportunities for investment depend on the institutional and policy environment that governments create. Therefore, the level and nature of the Bank's activities in a given country will be strongly influenced by the country's commitment to reform.

To foster a better investment climate and the development of strong institutions, the Bank will work closely and co-operatively with other international financial institutions to exploit synergies. In countries where progress on reform is slow, the Bank will cluster projects in reform-minded regions, at the municipal level, and in specific sectors, including the financial sector, in an effort to advance reform. The Bank hopes that through this strategy it will help create a critical mass of individual and business support for a "bottom-up" impetus for reform.

The paper *Moving Transition Forward* also reaffirms that, in order to fulfill its mandate, the Bank must be financially viable. Therefore, the Bank will adopt a strategic approach to portfolio management to ensure an appropriate balance of risks across countries, regions and products. A thorough risk analysis began in 1999 and will be completed in 2000. To ensure implementation, the paper also called for an enhanced role for Resident Offices.

CANADIAN PRIORITIES IN 1999

Private Sector Development

Canada has been a strong supporter of the private sector work of the Bank, recognizing that a strong private sector is key for the successful transition to a market economy. About 75 per cent of new commitments in 1999 were private sector operations, compared to about 80 per cent in 1998.

The Private Sector Focus of the Bank

The EBRD Agreement requires that the Bank achieve at least a 60/40 ratio (the so-called "portfolio ratio") in its private/public sector activities, both globally and in individual countries.

The global portfolio ratio was first satisfied in 1994. By 1999, nearly 70 per cent of the Bank's cumulative outstanding commitments were for private sector activities. Progress in reaching the individual country ratios, however, was mixed. At the end of 1999, the ratio was attained in only 10 of the Bank's 26 countries of operation, with two new countries, Lithuania and Turkmenistan, joining the list during the year.

The deadline for meeting the portfolio ratio requirement in individual countries of operation (i.e., five years after the approval of the Bank's first operation in that country) elapsed in 1999 for all but one country. The shortfall in meeting the ratio has been most evident in lower transition economies, where privatization has developed relatively slowly and where the Bank has often been active in developing public infrastructure critical to the development of a strong private sector. Many lower and intermediate transition economies still have relatively small and immature private sectors.

In 1999, most countries made progress towards meeting the ratio with the exception of Albania and Azerbaijan, where large public sector projects were signed. The Bank continues to pursue strategies in each country to reach at least a 60 per cent private sector ratio.

An increasingly important part of the EBRD's work with the private sector is its support of micro, small and medium-sized enterprises. In recognition of the potential for these enterprises to create jobs and growth, the EBRD developed in 1999 an SME sector strategy. The strategy has three pillars: finance, investment climate, and small and medium-sized enterprise (SME) support networks. The strategy explicitly recognizes that the poor investment climate – and not just limited access to financing – faced by many SMEs is an important impediment to the development of the sector. Therefore, the strategy calls on the EBRD to work to identify and promote the removal of the main obstacles to SME growth, as well as to encourage the development of strong business associations. The SME sector is seen as an important "constituency for reform" in the transition economies that can act as a counterweight to powerful vested interests that benefit from weak state governance.

In the past, much of the Bank's support for SMEs was provided via credit lines to local financial intermediaries that would on-lend to the small enterprise sector. The Russian crisis underlined, however, the need to review this approach in countries where financial regulation and supervision are weak and where concerns about systemic risks remain high. As a result, during 1999 the EBRD worked closely with the EU, bilateral institutions and the International Finance Corporation to establish a number of micro-enterprise banks in the region, including in Russia, Ukraine and Kosovo. The new micro-credit institutions are modelled on earlier successful efforts in Bosnia and Herzegovina. By the end of 1999, the Russian Small Business Credit Bank (in which the EBRD made a US$6-million equity investment and provided a US$30-million loan for on-lending to Russian businesses in 1999) had granted 1,250 new micro and small loans worth almost US$20 million with arrears (30 days past due) of just 0.2 per cent of the portfolio. The new micro-credit institutions in Ukraine and Kosovo have yet to undertake operations. Efforts are under way to establish a micro-finance bank in Albania.

The EBRD continued to extend credit lines to local banks to on-lend to micro, small and medium-sized enterprises in 1999. Notably, the EBRD committed 75 million euro and the EU 50 million euro to an SME finance facility for the 10 EU accession countries to encourage local banks and private equity funds to expand SME operations. The Russian Small Business Fund Program continued to operate in 1999, albeit at a scaled-down level due to the insolvency of a large number of participating banks in the wake of the Russian financial crisis. The Kazakhstan Small Business Program grew steadily in 1999 and by year end had disbursed over 3,200 loans for a total of over US$25 million with arrears (more than 30 days) of just 1.6 per cent. The Ukraine micro-credit program started showing good results in the second half of 1999, ending the year with 774 loans disbursed worth US$10.6 million and arrears of 2.4 per cent.

The Russia Small Business Fund

Established by the EBRD as a pilot project in 1993, following a request by the G-7, the Russia Small Business Fund (RSBF) was financed jointly by the EBRD, the G-7, the EU and Switzerland for the promotion of small- and micro-enterprise lending in Russia. At its inception, the Fund was valued at US$300 million. The Fund operates by lending to local banks that then on-lend to local SMEs. The RSBF also has a technical assistance facility whereby partner Russian commercial banks receive assistance from western experts. Canada, through the Canadian International Development Agency (CIDA), contributed US$8.1 million (C$11.3 million) to the program, including US$2 million in 1998.

In 1999, the effects of the Russian financial crisis on the Russian banking sector constrained many of the banks participating in the RSBF. Despite the problems of these banks, the micro, small and medium-sized business loan portfolio continued to perform relatively well, however. To preserve the important work of the RSBF in supporting SME development, the EBRD developed, in conjunction with foreign strategic investors a new bank, the Russian Small Business Credit Bank (KMB). During the course of 1999, the relatively healthy RSBF loan portfolio of insolvent Russian banks was transferred to the KMB. The strong shareholder base of the KMB, and its commitment to transparency and strong corporate governance, make it a model for local financial institutions in the region. The EBRD also continued to work in 1999 with partner banks in the RSBF that had co-operated with it through the crisis and that were potentially solvent.

Despite the difficult operating environment in 1999; the RSBF granted a total of 7,299 micro, small and medium-sized enterprise loans worth US$60 million, bringing the overall total since the program's inception in 1994 to almost 31,000 loans with a value of over US$380 million. Arrears (more than 30 days)[1] stood at 4.7 per cent. The RSBF model has been replicated by the EBRD in Moldova, Bosnia and Herzegovina, Kazakhstan and Ukraine.

[1] This includes arrears only for banks that are active under the program.

In 1999, the EBRD also extended its equity support to small and medium-sized enterprises through investments in private equity funds.[6] These funds are the most significant source of equity finance for SMEs in the region. By the end of 1999, the EBRD had committed 947 million euro to 60 private equity funds. The EBRD has also invested in 28 post-privatization equity funds, 25 venture equity funds and 21 large equity funds. The post-privatization funds make significant use of technical assistance provided by bilateral donors to assist companies in the privatization and immediate post-privatization periods.

[6] These are sponsored by private institutions and fund managers.

Together these equity funds have invested in over 500 companies throughout the region and have contributed to mobilizing total financing of 3.5 billion euro (C$5.1 billion) for companies in the region, as well as 270 million euro of technical assistance contributed by donors.

A Private Sector Development Initiative for Southeastern Europe

For the countries of southeastern Europe, the EU, working with the G-8 and the international financial institutions (IFIs), including the EBRD, launched the Stability Pact for South East Europe in 1999. The stability pact was inaugurated at the Heads of Government Summit in Sarajevo in July 1999. The pact's objective is the progressive integration of southeastern Europe into EU structures – with the eventual prospect of EU membership – as a way of promoting regional co-operation, security and development. Reflecting its comparative advantage relative to other IFIs in promoting private sector trade and investment, the Bank was given the leading role in developing a regional private sector approach.

The EBRD established the South Eastern Europe Action Plan (SEEAP) in 1999 in an effort to promote investment and assist in the economic recovery of the region. The SEEAP covers the EBRD's countries of operation in the region – Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FYR Macedonia and Romania – as well as Kosovo. Under the SEEAP, the EBRD will focus its support to the region on private sector investment, including corporations, SMEs and micro enterprises; commercial approaches to infrastructure (such as telecommunications, airport and municipal finance); and the financial sector. This focus is supported by the Stability Pact for South East Europe, which is an umbrella initiative under which multilateral and bilateral assistance to the region is being co-ordinated.

In 1999, the EBRD signed projects totalling 300 million euro in member countries in southeastern Europe. Of this amount, 95 million euro was for projects directed at the three members most affected by the Kosovo crisis: Albania, FYR Macedonia and Bosnia and Herzegovina. Given the low level of income of these countries, as well as their balance of payments problems, the EBRD drew on concessional co-financing to support some of these projects. CIDA explored establishing a technical support facility with the EBRD during 1999, and is likely to reach agreement with the Bank on this in 2000.

In 1999, the EBRD also undertook a number of activities in Kosovo, including working with other institutions to extend the operations of the micro-credit bank in Bosnia and Herzegovina to Kosovo, and to extend an existing equity fund operating in Albania to Kosovo. Unlike operations in member countries, the EBRD's activities in Kosovo cannot be funded from ordinary capital resources. The EBRD's Articles of Agreement limit such funding to Bank members. Therefore, Bank operations in Kosovo are financed by co-operation funds provided by donor governments or bilateral agencies.

Activities in the Financial Sector

In 1999, the EBRD updated its financial sector policy in light of recent developments and experience. A key element of the updated policy is its focus on country-specific approaches to financial sector development. The need to promote confidence and competition in an independent financial system are key themes of this policy. Confidence ensures that businesses and individuals utilize financial institutions. Competition and independence ensure that financial institutions respond to these demands. The EBRD will seek to build confidence in the sector primarily through investments that strengthen local institutions' governance and business practices. The EBRD's ability to shape the regulatory and supervisory environment, which is the building block for confidence, is limited by its investor role in the sector and potential concerns about conflict of interest. Nonetheless, the EBRD took the lead in 1999 in drafting a joint EBRD-IMF-World Bank paper on restructuring the Russian banking sector. To address competition and independence, EBRD investments in the sector will seek to increase the diversity of institutions and services, particularly to the private sector and SMEs, facilitate foreign direct investment, and strengthen the commercial orientation of state-owned financial institutions, particularly in preparation for privatization.

In 1999, the EBRD signed 33 financial sector operations, bringing total EBRD exposure to the financial sector region-wide to 4.2 billion euro (C$6.1 billion). By the end of 1999, the EBRD had signed loans valued at 2.275 billion euro to the banking sector, taken 726 million euro in equity positions in local banks, placed 216 million euro of equity in two micro-credit institutions and signed 83 million euro worth of operations with non-bank financial institutions. In most cases where the EBRD holds an equity stake in a local financial institution, it is represented on the supervisory board of the institution, where it promotes management accountability, good corporate governance, sound banking practices and proper environmental reviews and procedures. In 1999, the EBRD made equity investments in financial institutions in Ukraine, Armenia and Tajikistan. Participation in bank privatizations was a key factor behind equity investments in a number of advanced transition countries as well as in FYR Macedonia and Croatia.

During 1999 the EBRD also stepped up its activities in the non-bank financial sector, predominantly by taking minority equity stakes in insurance companies and pension fund management companies. A total of 10 new transactions were signed during the year with new commitments of 65.6 million euro (C$95.5 million). The EBRD is one of the largest financial investors in this sector, which also includes leasing, consumer finance, mortgage institutions, local asset management and mutual funds. By the end of 1999, the Bank had participated in nearly all the countries in the region where necessary institutional and regulatory regimes had been or were in the process of being introduced.

Environment

Support for the environment remained a key priority in 1999, reflecting the Bank's mandate to ensure sustainable long-term development in member countries. The Bank is directed by its statutes to "promote in the full range of its activities environmentally sound and sustainable development." The EBRD applies environmental due diligence to all its investment and technical co-operation operations.

Countries at more advanced stages of transition, especially those seeking accession to the EU, are now channeling more resources into investments to improve environmental conditions. In addition, increased attention is being given to improving the provision of essential municipal services, such as district heating, water supply and urban transport, as the availability and quality of these services are critical to underpinning economic development.

A key achievement for the EBRD in 1999 was the creation of the Energy Efficiency and Joint Implementation Fund. The fund will make equity investments in companies involved in providing energy efficient goods or services, or companies requiring a capital infusion to realize energy savings. The EBRD invested 20 million euro in the fund, and private sector investors provided a further 41 million euro.

In 1999, 14 environmental projects were signed with a total EBRD commitment of 196 million euro (C$285.3 million). Fifty-three environmental analyses, including one environmental impact assessment and 23 environmental audits, were conducted on projects approved by the Board of Directors in 1999. Project sponsors, as required by the Bank, undertake environmental impact assessments, analyses and audits that address potential environmental, health and safety and socio-economic impacts of a project. Environmental impact assessments and environmental analyses are conducted when potential impacts are significant. In the latter case, impacts can be readily identified, assessed and mitigated; in the former, they cannot. Environmental audits are performed when a project relates to an existing operation. The audit identifies past and present concerns, potential environmental risks and liabilities. In some cases both an audit and assessment/analysis are required.

Municipal and Environmental Infrastructure Policy

The adequate provision of basic public infrastructure and services is essential for the economic transition process. Poor quality and under-supply of municipal services, together with energy inefficiencies, have often limited productivity. The EBRD is pioneering operations in this area. In 1999, the EBRD became the first international financial institution to provide financing to municipal water and sewerage companies without a full financial guarantee from the municipality. The EBRD's operations policy for municipal and environmental infrastructure emphasizes private sector involvement as well as the development of appropriate regulatory structures and energy efficiency.

Despite the impact of the Russian financial crisis, which in many countries severely constrained the financial capacity of regional and municipal authorities, EBRD commitments remained at the same level as the previous year. By the end of 1999, the EBRD had committed a total of 572 million euro (C$832 million) to municipal infrastructure and services projects in about 125 municipalities in 15 countries.

The EBRD and Nuclear Safety

Canada and other G-7 countries have been working closely with the EBRD to improve nuclear safety in CEE countries and the former Soviet Union. To facilitate this work, Canada has contributed to the Nuclear Safety Account (NSA), which the EBRD administers on behalf of the G-7 countries and other contributors. The NSA is used primarily for making essential safety improvements to older-generation, Soviet-built reactors as part of a comprehensive program for their early decommissioning. As of December 31, 1999, pledges to the NSA totalled 289 million euro (C$420.7 million). Canada has contributed C$19.5 million. In April 1999, the Board of Directors of the EBRD approved the extension of the NSA for another three years.

On behalf of the G-7, the Bank has agreed to administer the US$768-million Chernobyl Shelter Fund for securing the sarcophagus around the destroyed – by nuclear accident – Unit IV reactor in Ukraine. The G-7 nations and the EU have pledged US$391 million, of which Canada has pledged a contribution of US$20 million. Following the statement of the June 1999 Summit in Cologne, the G-7 countries took the lead in organizing a second pledging conference to take place around May 2000. This initiative will ensure timely and efficient completion of the project.

Canada also supports the use of the EBRD's own resources to finance the upgrading of Soviet-designed nuclear power plants to Western safety standards. The EBRD applies strict conditions to this support. The completion of these plants must be a commercially viable and "least-cost" solution to the country's future electricity requirements; the completed plants must comply fully with Western nuclear safety standards; and any resulting increase in nuclear power in upgraded facilities must be offset by the closure of other unsafe nuclear plants.

Addressing Corruption and Poor Governance

The transition countries, like most emerging economies, face significant challenges in improving transparency and governance. The EBRD's mandate assigns it an important role in addressing governance issues by permitting it to operate only in countries committed to applying the principles of multi-party democracy and pluralism. These principles, when effectively implemented,

contribute to transparency in government policy making, act as a check on corruption and ensure an effective state. To underline their importance, the Bank has curtailed financing of public sector projects in countries where the government's commitment to the principles of multi-party democracy is weak, such as in Belarus. Canada fully supports this approach. Canada also continues to monitor closely developments in the Russian military campaign in Chechnya. The bulk of the EBRD portfolio in Russia is in the private sector, and no public sector projects have come to the Board of Directors for approval since the military campaign began in October 1999.

The EBRD seeks to improve governance and transparency largely through the projects it undertakes. Equity investments have been an important tool in this regard. The Bank's participation on the Board of Directors of companies in which it invests has been instrumental in improving the transparency of their accounting and business practices and their respect for minority shareholder rights. It is hoped that the success of these companies will demonstrate the importance of applying similar practices in the region. In addition, all Bank counterparts are examined to ensure they meet the highest standards of business practice. The EBRD's public procurement rules underline, for all doing business with the EBRD, the standards of ethics and conduct required during the procurement and execution of EBRD-financed projects.

The Bank's work in the area of legal transition also plays an important role in addressing issues of corruption and poor governance in its countries of operation. As such, the EBRD's participation in international standard-setting efforts was expanded in 1999. The EBRD worked closely with the World Bank on its Insolvency Initiative to develop international principles of bankruptcy. The EBRD is also a member of the Global Corporate Governance Forum of the Organisation for Economic Co-operation and Development (OECD). To promote transparency, the EBRD each year publishes a survey of the extensiveness and effectiveness of various commercial laws in the region in its legal journal, *Law in Transition*.

The medium-term priorities assign importance to addressing issues of corruption and governance, as these are key factors influencing the investment climate in the Bank's countries of operation. Key efforts in this regard include strengthening the policy dialogue with governments by achieving joint agreement on necessary improvements. Important high-level venues for this dialogue are the Foreign Investment Advisory Councils, which exist in Russia, Ukraine and Kazakhstan. They bring together government ministers, political leaders from the Bank's countries of operation, representatives of the international business community and high-ranking EBRD officials twice yearly to discuss how to improve the investment climate in the countries.

Institutional Developments

Organizational Changes

In the summer of 1999, the EBRD implemented a number of organizational changes to sharpen the focus of the Bank's structure and management and to facilitate implementation of the medium-term priorities. Key among the changes was a reorganization of the Banking Department into six business groups: three country groups (Central Europe; Russia and Central Asia; and Southern and Eastern Europe and the Caucasus) and three sector groups (Financial Institutions; Infrastructure; and Industry and Commerce). A special unit responsible for the investment climate as it relates to SMEs and SME support networks was also created to report directly to the Vice-President of Banking. The decision was also taken to strengthen resident offices to improve portfolio monitoring and the efficiency and effectiveness of Bank projects. Strengthening resident offices will be done by shifting some banking staff, including country-team directors, from headquarters in London to countries of operation.

In 1999, the EBRD created the position of Chief Compliance Officer, responsible for promoting good governance and ensuring that the highest standards of integrity are applied in all Bank activities. New guidelines for the selection, training and supervision of EBRD nominees to boards of directors of enterprises in which the Bank has invested were adopted in 1999 to ensure the highest governance outcomes.

In the autumn of 1999, Nicholas Stern, the Chief Economist and Special Counselor to the President, resigned. As Chief Economist and Special Counselor, he helped define the Bank's strategic role in the region and explored economic issues related to transition. Early in 2000, EBRD President Horst Köhler appointed Professor Willem H. Buiter as the Bank's new Chief Economist. Prof. Buiter has written extensively on macroeconomic policy and holds a position at Cambridge University. He is also a member of the Bank of England's Monetary Policy Committee.

Introduction of the Euro

The EBRD changed its reporting currency from ECU to euro on January 1, 1999, when the euro replaced the currencies of each of the 11 participating countries for accounting purposes. The main impact for the Bank was the modification of its processing and accounting systems. Since these systems were successfully modified prior to the changeover, there was no adverse impact on either the Bank or its clients on January 1, 1999.

Year 2000 Compliance

The EBRD's business was uninterrupted over the millennium date change. This was achieved by ensuring that all information technology systems in the EBRD were Y2K compliant by March 1999, by identifying potential high-risk clients and working with them through 1999 to reduce risks, and by including Y2K resolutions in all standard loan agreements for several years prior to 2000.

Managing Canada's Interests

The highest authority in the Bank is the Board of Governors. Member countries are represented by a Governor and an Alternate Governor. The Honourable Paul Martin, Minister of Finance, is the Canadian Governor and Donald Campbell, Deputy Minister of Foreign Affairs, is the Alternate Governor.

The Board of Directors is responsible for the general operations of the Bank. The Board is composed of 23 members, of which four are non-European members. Canada is the third largest non-European shareholder, after the United States and Japan, and by virtue of its share has the right to elect its own Director. Canada also represents Morocco at the Bank. The Canadian Director is Patrice Muller. The Minister (Economic/Commercial) at the Canadian High Commission in London, Tom MacDonald, is the non-resident Alternate Director who represents Canada in the absence of the Canadian Director.

Within the Canadian government, responsibility for oversight of the EBRD's activities resides with the International Finance and Economic Analysis Division of the Department of Finance. In consultation with the Department of Foreign Affairs and International Trade (DFAIT) and CIDA, the Department of Finance regularly reviews the Bank's policy papers and proposed country strategies and provides advice to the Canadian Director.

To ensure the EBRD remains additional and contributes to the transition process, Canada continued to advocate EBRD activity in Ukraine and other countries in lower or intermediate stages of transition respecting the principles of multi-party democracy and making efforts at reform, provided the increased risks could be accommodated in the portfolio. Canada has supported the development within the Bank of a "wholesale" approach to activities, under which the Bank channels financing to SMEs through lines of credit or equity investments in local banks and other financial intermediaries in its countries of operation. In light of the Russian crisis, Canada has encouraged the EBRD to pay greater attention to systemic risks in the financial sector and to improve co-ordination with other institutions, particularly the World Bank, in addressing issues of regulation and supervision.

Canada's Voting Record

Canada and other shareholders typically raise concerns and questions about specific Bank operations before they get to the Board. As a result, decisions at the Board are generally taken by consensus without a formal vote. Nevertheless, the Canadian Director abstained on:

- a guarantee for a telecommunications project in Poland because Canada could not support the concept of the EBRD providing a guarantee that would benefit another multilateral financial institution (the European Investment Bank), especially given that both institutions are primarily owned by the same shareholders.

Canada has continued to underline the importance of the project-centered, private sector focus of the EBRD. It has also argued that the Bank cannot relax its efforts to expand the share of its private sector operations. The last 10 years of transition experience have, however, underlined the importance of the state and its institutions in private sector development. Therefore, Canada fully supports the medium-term priorities emphasis on improving the investment climate. The Canadian Director has frequently spoken in the Board on the importance of the Bank's charter requirement that member countries be committed to market reform and multi-party democracy.

With respect to its own contributions to the EBRD, Canada continued to play a leading role in the adoption of a zero nominal growth budget for 1999 and 2000. Canada has been a strong proponent of greater EBRD transparency, believing that the Bank should be a model of behaviour for the region. Therefore, Canada has pushed hard for the EBRD to increase the transparency of its operations and policies. In 1999, the Bank began a review of its Public Disclosure of Information Policy. It also began to publish on its Web site draft sectoral policies.

The Canadian Director is a member of the Financial and Operations Policies Committee, which reviews financial policies, including the Bank's borrowing policy, general policies relating to operations, and procedures and reporting requirements.

Canadian Commercial Interests

The EBRD offers a wide variety of opportunities for Canadian businesses. One of the tasks of the Canadian office is to make Canadian business people aware of investment opportunities, explain how the Bank's contracting works and ensure that all contracts are awarded in a transparent and fair manner.

To achieve these objectives, the Canadian office provides market information and intelligence to Canadian firms, advises Canadian project sponsors on EBRD financing options, develops commercial co-financing opportunities with the Export Development Corporation and Canadian financial institutions, identifies and sources EBRD procurement opportunities with DFAIT and Industry Canada, and promotes Canadian technical co-operation activities and official co-financing between the EBRD and CIDA.

In 1999, three Canadian-sponsored projects were signed representing EBRD financial commitments of US$46.5 million. (The aggregate size of the three projects is US$312 million.) A description of each of the Canadian-sponsored projects is given in Annex 2. In 1999, Canadian consultants also won five EBRD technical co-operation assignments totalling approximately 654,000 euro. The largest of these assignments was a 394,000 euro project to assist the EBRD with due diligence in the Russian alluvial gold mining sector, which led to 130 million euro in EBRD pre-production financing.

Canadians are also well represented on EBRD staff. At the end of 1999, Canadians accounted for 4.8 per cent of the Bank's professional positions, above Canada's 3.4-per-cent share of the institution's capital. It is noteworthy that a Canadian heads the Baltic Team and another Canadian is the deputy head of the Bank's resident office in Kazakhstan.

Promoting Canada's Interests

Members of the Canadian office made seven visits to Canada in 1999 to meet with business people, conduct seminars, speak at conferences and consult with government officials. This included the Canadian Director accompanying EBRD President Köhler in March to meet members of the Canadian government, notably Prime Minister Jean Chrétien, as well as members of the Canadian business community.

Canada's commercial interests in the region were also promoted by:

- participation of the Canadian Director and Alternate Director in the Team Canada mission to Ukraine and Poland;
- travel by the Canadian Director to Romania and the Slovak Republic as part of signing ceremonies for EBRD-Canada sponsored projects; and
- promotion by the Canadian Director's assistant of the Canadian office and the EBRD as instruments for advancing Canadian commercial interests to a telecommunications trade mission from Canada travelling in Russia.

CHALLENGES AHEAD

Most of the countries of the region have made significant progress in economic and political transition since the early 1990s. Throughout this process the EBRD has, both directly and through the demonstration effects of its projects, helped to advance the transition process. The Bank has been important in catalyzing private sector investment in the region and has been a strong force in promoting entrepreneurship, particularly through its support for SMEs.

The Russian crisis has highlighted the challenges for the future of the transition process. It has underlined the importance of an effective institutional framework for a well-functioning market economy. It has shown that those countries with strong institutions and good regulatory frameworks should be in a good position to continue to make progress in the transition process in the coming year. Those with weak underlying fundamentals, however, will remain extremely vulnerable to external shocks.

Good governance will continue to play a critical role in these countries. Good corporate governance is one aspect of this role. The state, however, also has a strong role to play in supporting an enabling investment climate, by promoting sound institutions, administering tax collection and improving legal and regulatory frameworks. It must also ensure that appropriate new legislation is not only developed, but is properly implemented and enforced.

In assisting its member countries in 2000, the EBRD in turn will face the challenge of managing its portfolio in an increasingly uncertain and risky environment. The Bank will need to pay increased attention to balancing its portfolio across countries, products and risk categories. The EBRD's medium-term strategy for 2001-04 will be critical in ensuring the Bank has sufficient flexibility to meet new challenges in the coming years and in providing strong direction to the Bank in fulfilling its mandate.

A clear lesson from the crisis is that transition in the region is a complex and difficult process that will take longer than many initially expected. The primary responsibility for shaping a response to the challenges of transition lies with the countries themselves. The international financial institutions, however, particularly the EBRD, have an important supporting role to play.

Contacting the Office of the Director for Canada

The Canadian Director's office at the EBRD may be reached at:

Office of the Director for Canada and Morocco
European Bank for Reconstruction and Development
One Exchange Square, Room 8.15
London, EC2A 2JN
United Kingdom

Mr. Patrice Muller, Director	Tel:	44-20-7338-6457
Mr. Tom MacDonald, Alternate Director[1]	Tel:	44-20-7338-6507
Ms. Josée Berthiaume, Director's Assistant[2]	Tel:	44-20-7338-6458
Mr. John Kur, Director's Assistant[3]	Tel:	44-20-7338-6509
Mrs. Alicja Kujawa, Executive Secretary	Tel:	44-20-7338-6507
	Fax:	44-20-7338-6062
	Internet address:	kujawaA@ebrd.com

[1] Resident at the Canadian High Commission in London.

[2] Responsible for policy matters.

[3] Responsible for business development and investor liaison.

For More Information on the EBRD

The Bank releases considerable information on its various activities. Bank publications include information guides (e.g., *Financing With the EBRD*), special reports (e.g., *The Annual Report, Transition Report*), country strategies and assorted fact sheets.

Information can also be obtained on the Bank's Web site:

http://www.ebrd.com/

Requests for information can be addressed to:

Publications Desk
European Bank for Reconstruction and Development
One Exchange Square
London, EC2A 2JN
United Kingdom
(Fax: 44-20-7338-7544)

ANNEX 1

THE BANK'S FINANCIAL ACTIVITIES

The Bank's financial activities are divided into ordinary and special operations, depending on the source of funds. Ordinary operations are financed from the ordinary capital resources of the Bank, which comprise subscribed capital, market borrowings and income from loans and investments. Special operations are those financed by "Special Funds" for specially designated purposes that are typically outside the Bank's regular activities. Unlike other regional development banks, however, the EBRD does not operate a concessional or "soft" loan window.

Ordinary Capital Resources

At the end of 1999, the total authorized capital of the Bank was 20 billion euro (about C$35 billion). Canada has subscribed to 3.4 per cent – or 680 million euro (about C$1.2 billion) – of the Bank's authorized capital. Canadian contributions to the Bank's capital are made in US dollars (at a pre-determined euro/US$ exchange rate).

In 1999, Canada made its second purchase of shares under the first capital increase (which came into effect April 3, 1997, and doubled the initial 10-billion-euro capital base). Under the first capital increase, 77.5 per cent of our share is "callable," meaning that the Bank can request these resources in the unlikely event that it requires them to meet its financial obligations to bondholders; the balance, or 22.5 per cent, is "paid-in." Payments will be made in eight equal annual installments of US$12,145,331.25 (40 per cent in cash and 60 per cent in non-interest-bearing demand notes encashed over five years). Under the initial capital, 30 per cent was paid-in over five years (split evenly between cash and notes encashed over a three-year period) and 70 per cent callable. Canada completed payments for the initial capital in April 1997. The table below details Canadian payments to the Bank in US dollars.

Canada's contributions to the Bank's capital are non-budgetary expenditures because our shares in the Bank are considered an asset. Nonetheless, Canada's contributions to the Bank do increase the Government's borrowing requirements.

Canadian Payments to the EBRD

Year	Notes	Cash	Encashment of notes	Total cash outlay
		(in US dollars)		
1991	11,903,502	11,903,502	11,903,502	23,807,004
1992	11,903,502	11,903,502	3,967,834	15,871,336
1993	11,903,502	11,903,502	7,935,668	19,839,170
1994	11,903,502	11,903,502	11,903,502	23,807,004
1995	11,903,502	11,903,502	11,903,502	23,807,004
1996	–	–	7,935,668	7,935,668
1997	–	–	3,967,334	3,967,334
1998	7,287,198	4,858,132	1,457,439	6,315,572
1999	7,287,198	4,858,132	2,914,878	7,773,010
Total	74,091,906	69,233,774	63,889,327	133,123,102

Market Borrowings

At the end of 1999, cumulative borrowings by the Bank totalled 12.6 billion euro (C$18.3 billion) with an average maturity of 8.1 years at an average cost of funds of LIBOR (London Inter-Bank Offered Rate) minus 35 basis points. Funds have been swapped into floating-rate instruments, primarily in US dollars, euro and Deutsche Marks.

Standard & Poor's has assigned the Bank an AAA long-term and A-1+ short-term credit rating. Moody's Investors Service has similarly rated the EBRD long-term bonds triple-A.

Special Operations

The EBRD administers a number of bilateral and multilateral concessional funds. Canada has contributed to the following special funds:

The Canada Technical Co-operation Fund – The main purpose of this fund is to provide financing to hire Canadian consultants for EBRD projects. Canada has contributed C$7.66 million since the fund was established in 1992.

Nuclear Safety Account (NSA) – This facility was established in 1993 to help finance the closure of the Chernobyl nuclear power plant and to improve safety conditions at nuclear power plants in countries of operation until the plants can be closed. The NSA complements other bilateral and multilateral nuclear safety technical assistance and functions in parallel with multilateral efforts to achieve broader energy sector reform in the region. Canada has contributed C$19.5 million to the total fund of 289 million euro (C$420.7 million).

Chernobyl Shelter Fund – The main purpose of this fund is to secure the sarcophagus around the destroyed Unit IV nuclear reactor in Ukraine. The total estimated cost of this eight-year project is US$768 million, of which US$391 million has been pledged so far. Canada has pledged a contribution of US$20 million to be paid over six years starting in 1998.

Russia Small Business Fund (RSBF) – The purpose of this fund is to establish a facility for small business finance and micro-lending in various regions of Russia. Canada has contributed US$8.1 million towards the US$300-million fund, including a new contribution of US$2 million in 1998 for investments in northern Russia in response to the success of the fund. The RSBF was established in 1993 as a pilot project and became permanent in 1995.

Technical assistance in support of the Ukraine Micro, Small and Medium-Sized Enterprises Line of Credit II – CIDA will provide C$3 million for technical assistance services by qualified Canadian organizations to Ukrainian commercial banks receiving loans under the EBRD's Ukraine Micro, Small and Medium-Sized Enterprises Line of Credit II for on-lending to micro, small and medium-sized enterprises. The technical assistance will include risk- and loan-evaluation training. The EBRD Board of Directors approved the credit line in May 1998. Activities to be undertaken as part of this facility were on hold in 1998 and 1999 pending ratification of the facility by the Ukrainian Rada. This occurred early in 2000, and activities, including the procurement of Canadian services, can now commence.

Annex 2

EBRD – Canadian-Sponsored Project Activity in 1999

Date of signing	Canadian company	Project country	Project name	Type of financing	Sector	EBRD commitment (millions of euro)	Total project cost (millions of euro)
January 1999	Telesystem International Wireless Corporation	Romania	MobiFon GSM Phase II Financing	Debt	Tele-communications	9.882	153.170
August 1999	TrizecHahn	Slovak Republic	Polus Centre	Debt	Property development	23.0	68.9
December 1999	TrizecHahn	Regional	Trigranit Group	Equity	Property development	13.6	88.0
Total (euro)						**46.5**	**310.1**

Annex 3

Doing Business With the EBRD

General inquiries about working with the EBRD should be directed to the Office of the Director for Canada or to the Bank's **Communications Department** in London (tel: 44-20-7338-6096; fax: 44-20-7448-6690).

Canadian Project Sponsors: Canadian companies interested in potentially sponsoring a project with the EBRD are requested to direct initial inquiries either to **Project Inquiries** in London (tel: 44-20-7338-6282 or 44-20-7338-6252; fax: 44-20-7338-6102) or to the Bank's resident office in the country of operation. Summaries of EBRD private sector operations can be obtained on the Bank's Internet site: http://www.ebrd.com/.

Canadian Suppliers of Goods and Works: The EBRD makes available information on all stages of public sector project development, from the point a project has been identified by the Bank through to its approval. Procurement opportunities and co-financing notices, as well as contract awards information, can be accessed on the Bank's Web site free of charge (see address above).

Canadian Consultants: The EBRD's Web site contains technical co-operation notifications and invitations for expressions of interest for consultancy services pertaining to both public and private sector projects. The EBRD also makes use of the World Bank's electronic DACON (Data on Consultants) registration system. Although it is not required for consultants to register with DACON to be eligible for EBRD assignments, it is nonetheless advisable as a useful marketing tool. Requests for DACON registration packages should be sent directly to:

DACON Information Centre
World Bank
1818 H Street
Washington, DC 20433 USA

Individual Canadians: The EBRD maintains a recruitment section on its Web site which provides information on specific employment competitions at the Bank as they become available. In general, applications for employment for both permanent positions and summer jobs should be sent to:

Franco Furno, Director of Personnel
Personnel Department
European Bank for Reconstruction and Development
One Exchange Square
London, EC2A 2JN
United Kingdom

Annex 4

EBRD Membership – As at December 31, 1999

	Share of the Bank's capital (%)
European Members	
Austria	2.28
Belgium	2.28
Cyprus	0.10
Denmark	1.20
Finland	1.25
France	8.52
Germany	8.52
Greece	0.65
Iceland	0.10
Ireland	0.30
Israel	0.65
Italy	8.52
Liechtenstein	0.02
Luxembourg	0.20
Malta	0.01
Netherlands	2.48
Norway	1.25
Portugal	0.42
Spain	3.40
Sweden	2.28
Switzerland	2.28
Turkey	1.15
United Kingdom	8.52
European Union	3.00
European Investment Bank	3.00
Non-European Members	
Australia	0.50
Canada	**3.40**
Egypt	0.10
Japan	8.52
Korea	1.00
Mexico	0.15
Morocco	0.05
New Zealand	0.05
United States	10.00

	Share of the Bank's capital (%)
Countries of Operation	
Albania	0.10
Armenia	0.05
Azerbaijan	0.10
Belarus	0.20
Bosnia and Herzegovina	0.17
Bulgaria	0.79
Croatia	0.36
Czech Republic	0.85
Estonia	0.10
FYR Macedonia	0.07
Georgia	0.10
Hungary	0.79
Kazakhstan	0.23
Kyrgyzstan	0.10
Latvia	0.10
Lithuania	0.10
Moldova	0.10
Poland	1.28
Romania	0.48
Russian Federation	4.00
Slovak Republic	0.43
Slovenia	0.21
Tajikistan	0.10
Turkmenistan	0.01
Ukraine	0.80
Uzbekistan	0.21

Report on Operations Under the European Bank for Reconstruction and Development Agreement Act

2000

Canada

Report on Operations Under the European Bank for Reconstruction and Development Agreement Act

2000

Prepared by:
International Trade and Finance Branch
March 2001

Department of Finance Canada   Ministère des Finances Canada

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http://www.fin.gc.ca/

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Introduction

The European Bank for Reconstruction and Development (referred to in this document as the EBRD or the Bank) was established in 1991. Its aim is to foster the transition towards open, market-oriented economies in Central and Eastern Europe, as well as in the successor states of the former Soviet Union, and to promote private and entrepreneurial initiative in countries in this region that are committed to the fundamental principles of multi-party democracy, pluralism and a market economy (see Annex 4 for a list of the EBRD's 26 countries of operation).

The EBRD functions as a development bank in much the same way as the World Bank and other regional development banks. The EBRD, however, is distinctive in three areas. First, its overriding focus is on the private sector and support for the transition from central planning to stable market economies. Its Charter stipulates that not less than 60 per cent of its financing commitments should be directed either to private sector enterprises or to state-owned enterprises implementing a program to achieve private ownership and control. Second, the EBRD's mandate gives it a particular focus on the promotion of democratic institutions and human rights in its countries of operation. Finally, the EBRD is explicitly committed under its Articles of Agreement to ensuring the environmental sustainability of all its projects.

The Bank seeks to help its 26 countries of operation to implement structural and sectoral economic reforms, taking into account the particular needs of countries at different stages in the transition process. In particular, its private sector activities focus mainly on enterprise restructuring, including the strengthening of financial institutions, and the development of infrastructure needed to support the private sector. The EBRD has 61 members: 59 countries, the European Union (EU) and the European Investment Bank (see Annex 4 for a list of the members).[1]

Canada is the eighth largest shareholder (tied with Spain), following the other Group of Seven (G-7) countries and Russia. Our formal participation is authorized under the European Bank for Reconstruction and Development Agreement Act, which was promulgated in February 1991. Article 7 of the Act states that:

> The Minister [of Finance] shall cause to be laid before each House of Parliament by March 31 of each year or, if that House is not then sitting, on any of the thirty days next thereafter that it is sitting, a report of operations for the previous calendar year, containing a general summary of all actions taken under the authority of this Act, including their sustainable development aspects within the meaning of Article 2 of the Agreement, and their human rights aspects.

This report responds to this requirement and reviews the activities and operations of the Bank for the year 2000.

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[1] The Federal Republic of Yugoslavia became a member of the Bank in January 2001, raising the number of members to 62 and the number of countries of operation to 27.

Benefits of Membership

As a major trading nation, Canada has a stake in global peace and stability. The successful integration of Central and Eastern Europe and the former Soviet Union into the world economy and global institutions helps to promote peace and stability. The EBRD, by fostering continued economic reform in the region, is contributing to the region's integration into the world economy and to its stability.

EBRD membership provides a number of specific benefits:

- The Minister of Finance is a Governor of the Bank and elects an Executive Director to its 23-member Board of Directors. This representation allows Canada to have high-level influence on decisions taken by the EBRD on investments in the region and on policies to move forward regional development.
- The EBRD provides trade opportunities for the Canadian private sector, allows a diversification of international markets for Canadian business and supports investments by Canadian business in the region.

Role and Mandate of the EBRD

The EBRD:

- fosters the transition of former centrally planned economies of Central and Eastern Europe and the successor states of the former Soviet Union towards market-oriented economies;
- promotes private entrepreneurial initiative (targets at least 60 per cent of its resources to private sector projects with the balance in support of commercially viable state sector projects that promote private sector development);
- operates only in countries committed to applying the principles of multi-party democracy, pluralism and market economics;
- promotes environmentally sound and sustainable development; and
- operates on a self-financing basis.

The EBRD's operations to advance the transition to a market economy are guided by three principles: maximizing transition impact, additionality and sound banking. Financing is provided for projects that expand and improve markets, help build the institutions necessary for underpinning the market economy, and demonstrate and promote market-oriented skills and sound business practices. EBRD financing must also be additional to other sources of financing, and not displace them, further ensuring that the Bank contributes to the transition process. Finally, Bank projects must be sound from a banking perspective, thus demonstrating to private investors that the region offers attractive returns. Adherence to sound banking principles also helps ensure the financial viability of the EBRD and hence its attractiveness as a co-investment partner for the private sector.

In promoting economic transition in its countries of operation, the Bank acts as a catalyst for increased flows of financing to the private sector. The capital requirements of these countries cannot be fully met by official multilateral and bilateral sources of financing, and many foreign private investors remain hesitant to invest in the region, particularly the eastern part. By providing an umbrella under which wider funding for private sector investment can be assembled, the EBRD plays a catalytic role in mobilizing capital. In 2000, for every euro the EBRD invested, it mobilized an additional 1.9 euro from the private sector and multilateral and bilateral agencies.[2]

Indeed, the projects of the Bank serve a dual purpose. They are intended not only to directly support the transition from a command to a market economy in countries of operation, but also to create a demonstration effect to attract foreign and domestic investors. Like the World Bank Group's International Finance Corporation, the Bank is required to operate on a strictly commercial basis and to attract companies to invest in countries through financially viable projects, not through subsidies.

[2] On December 29, 2000, one euro purchased 1.4092 Canadian dollars and one US dollar purchased 1.5002 Canadian dollars.

Key Developments in 2000

Strong growth returned to most of the transition countries in 2000. Real gross domestic product (GDP) grew by just over 5 per cent for the region as a whole, up substantially from 2.1 per cent in 1999. The recovery reflects strong growth in the Commonwealth of Independent States (CIS),[3] which saw real GDP expand 7.4 per cent in 2000 following 3.1-per-cent growth in 1999, largely due to a strong upturn in Russia. In the remaining transition economies of Central Europe and the Baltic States (CEB)[4] and Southeastern Europe[5] output increased 4.0 per cent, up from 1.2 per cent in 1999, as the upturn in western Europe increased exports.

Despite the recovery in the CIS, the level of real GDP at the end of 2000 stood at around 60 per cent of its pre-transition level. The recovery in the CIS during the past two years has been driven largely by external factors rather than domestic policy, raising questions about the sustainability of the recovery. In contrast, by the end of 2000 most countries in CEB attained, or nearly so, pre-transition levels of output. This reflects the faster pace of reform in CEB, as well as the fact that at the start of the transition process these countries were more familiar with market principles and market-supporting institutions. Although rapid initial reform efforts in CEB resulted in output and employment losses that were more significant than in much of the CIS, these losses were relatively quickly recouped as competition flourished. In the CIS output and employment losses, though initially less pronounced, continue to persist as incomplete reform efforts have failed to sufficiently unleash private economic activity. As a result, the first decade of transition has seen a significant divergence in living standards between CEB and the CIS, one that is likely to persist.

The year 2000 saw the greatest progress in reform since 1997, as measured by the EBRD's transition indicators (see table on page 9). Progress was achieved across most countries and dimensions of reform. However, considerable challenges in developing the institutions that are necessary to support a market economy remain throughout much of the region. This is particularly true for the countries in Southeastern Europe and the CIS, where legislative and regulatory changes have often been extensive, but the implementation and enforcement, and hence the effectiveness, of the new laws and regulations remain weak. The continuing weakness of institutions in the CIS and Southeastern Europe means macroeconomic imbalances will remain difficult to manage, with financial sectors vulnerable to bouts of instability.

The following table ranks transition countries according to a number of indicators.

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[3] The CIS includes the following countries: Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan.

[4] CEB includes the Czech Republic, Hungary, Poland, the Slovak Republic, Slovenia and the three Baltic States (Estonia, Latvia and Lithuania).

[5] Southeastern Europe includes Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FYR Macedonia, Romania and the Federal Republic of Yugoslavia, which became a member of the Bank in early 2001. Kosovo is a province of the Federal Republic of Yugoslavia.

Progress in Transition in Central and Eastern Europe, the Baltic States and the CIS

			Enterprises			Market and trade			Financial institutions	
Countries	Population (millions, mid-2000)	Private sector share of GDP in %, mid-2000 (EBRD estimate)	Large-scale privatization	Small-scale privatization	Governance and enterprise restructuring	Price liberal-ization	Trade and foreign exchange system	Compe-tition policy	Banking reform and interest rate liberalization	Securities markets and non-bank financial institutions
Albania	3.3	75	2	4	2	3	4+	2-	2+	2-
Armenia	3.8	60	3	3+	2	3	4	1	2+	2
Azerbaijan	8.1	45	2-	3+	2	3	3+	2	2	2-
Belarus	10.2	20	1	2	1	2-	2-	2	1	2
Bosnia and Herzegovina	4.1	35	2	2+	2-	3	3	1	2+	1
Bulgaria	8.1	70	4-	4-	2+	3	4+	2+	3	2
Croatia	4.5	60	3	4+	3-	3	4+	2+	3+	2+
Czech Republic	10.3	80	4	4+	3+	3	4+	3	3+	3
Estonia	1.4	75	4	4+	3	3	4+	3-	4-	3
FYR Macedonia	2.0	55	3	4	2+	3	4	2	3	2-
Georgia	5.4	60	3+	4	2	3+	4+	2	2+	2-
Hungary	10.0	80	4	4+	3+	3+	4+	3	4	4-
Kazakhstan	14.8	60	3	4	2	3	3+	2	2+	2+
Kyrgyzstan	4.7	60	3	4	2	3	4	2	2+	2
Latvia	2.4	65	3	4+	3-	3	4+	2+	3	2+
Lithuania	3.7	70	3	4+	3-	3	4	3-	3	3
Moldova	4.3	50	3	3+	2	3+	4	2	2+	2
Poland	38.7	70	3+	4+	3	3+	4+	3	3+	4-
Romania	22.3	60	3	4-	2	3	4	2+	3-	2
Russia	145.4	70	3+	4	2	3	2+	2+	2-	2-
Slovak Republic	5.4	75	4	4+	3	3	4+	3	3	2+
Slovenia	2.0	55	3	4+	3-	3+	4+	3-	3+	3-
Tajikistan	6.3	40	2+	3+	2-	3	3+	2-	1	1
Turkmenistan	5.1	25	2-	2	1	2	1	1	1	1
Ukraine	49.5	60	3-	3+	2	3	3	2+	2	2
Uzbekistan	24.9	45	3-	3	2-	2	1	2	2-	2

Source: EBRD, *Transition Report – 2000.*

Note: The classification of transition indicators uses a scale from 1 to 4 where 1 implies little or no progress with reform and 4 implies a market economy. Most advanced industrial economies would qualify for the 4+ rating for almost all the transition indicators.

Highlights of Macroeconomic Performance

- Real GDP growth strengthened to over 5 per cent for the region as a whole, the highest growth rate since the start of transition and the first time in the region's history it has posted two consecutive years of growth. The strong recovery was broadly based across the region.
- Inflation pressures increased throughout much of Central Europe in 2000, while in the CIS inflation moderated in most countries, though it remained at double-digit levels.
- In many CIS countries the currency devaluations of 1998-99 contributed to a sharp increase in external public debt in local currency terms and, in some cases, debt management problems.
- Although current account deficits narrowed in a number of countries in Central Europe, they remain relatively high.

Russia

Macroeconomic performance during 2000 far exceeded expectations. Buoyed by the devaluation of the ruble in 1998 (and its further depreciation in 1999), as well as a sharp increase in average oil export prices over 1999 levels, real GDP grew an estimated 7.7 per cent in 2000, up from 3.5 per cent in 1999. By end 2000 real GDP had surpassed its pre-1998 crisis level, but was still far below its pre-transition level. The federal government's fiscal position improved markedly as revenues increased substantially due to the upturn in the economy, as well as some modest efforts by the government to re-establish control over public finances. Russia's external position, as reflected by its current account balance, also improved significantly through 2000 due largely to higher energy exports.

While the improved external position was a positive development, it also complicated macroeconomic management. As Russian exporters sought to convert their foreign exchange earnings into rubles, the strong demand for the domestic currency led to appreciation pressures on the ruble that threatened to overturn the competitiveness gains resulting from the 1998-99 ruble depreciation. To counteract this, the Russian central bank supplied rubles to satisfy the strong demand for the currency, but this contributed to inflation pressures in the domestic economy. Despite limited stabilization tools, the authorities were able to contain these inflationary pressures. As a result, inflation ended the year down from its 1999 level.

Despite strong economic growth in 2000, the Russian economy remains vulnerable to external and internal shocks. The recovery in non-commodity-related production has thus far been largely driven by the ruble's significant real depreciation in the wake of the Russian financial crisis in 1998, which has led to significant substitution of domestic goods for foreign ones as imports have become much more expensive with the lower value of the ruble. Sustaining competitiveness will require deep structural reforms in the enterprise sector as well as significant new investment to increase efficiency and productivity. Limited progress has been made in this direction over the past year. Despite the government's approval of a comprehensive 10-year economic development program in July 2000, which includes improving the business climate as a priority, the business climate remains uninviting as witnessed by the still substantial capital outflows from Russia. Similarly, little has been done to strengthen Russia's financial system. Financial institutions remain under-capitalized and poorly regulated. Efforts to reform the financial sector – through the creation of a bank restructuring agency (ARCO) and enactment of laws on the insolvency of credit institutions – have been largely undermined by the lack of regulatory enforcement by the central bank.

Central Europe and the Baltic States

Stronger growth in 2000 was largely export-driven as the upturn in western Europe pulled in more exports from Central Europe and the Baltic States, offsetting the possible detrimental effect of high oil prices on these energy-dependent economies. Strong investment demand, spurred by the prospect of EU accession, also buoyed growth in 2000. The strong performance of exports led to some narrowing of current account deficits in a number of countries, which is particularly striking given the high energy content of imports and the significant rise in energy prices. Current account deficits remained high, however, at close to 5 per cent of GDP or more, in the majority of countries in Central Europe. In most countries, these deficits have been financed by foreign direct investment rather than debt-creating capital inflows, alleviating some of the concerns normally associated with persistent high current account deficits. Rising energy prices also contributed to price pressures in much of the region, though inflation remained under control in all countries.

The sound economic performance of many countries of Central Europe and the Baltic States over the last few years has been fostered by significant gains in competitiveness due to successful enterprise restructuring and by the creation of market-supporting institutions (fiscal, legal, financial and social). Poland and Hungary in particular have advanced significantly in the transition process (see table on page 9) and appear well poised for long-term sustained economic growth.

Southeastern Europe

Growth strengthened in all countries in Southeastern Europe with the exception of Albania, which saw growth remain steady at just over 7 per cent. Like Central and Eastern Europe and the Baltic States, many countries in Southeastern Europe also benefited from stronger growth in western Europe in 2000, which pulled in exports from the region. Export-led growth appeared particularly strong in Bulgaria and Romania. In the latter increased exports contributed to a return to growth following three years of recession. In a number of countries, notably Bulgaria, EU accession prospects also spurred strong investment growth, reflecting significant efforts in recent years to move forward with reform. However, the growth of investment demand in much of the rest of the region was dampened by the lingering political instability in the Federal Republic of Yugoslavia throughout much of 2000 and the slow pace of macroeconomic and structural reforms. However, the recent election of a reform-minded government in Croatia and the election of a new President in the Federal Republic of Yugoslavia brightened the region's prospects in 2000.

Despite the progress to date, Southeastern Europe faces significant challenges, principally as a result of its uneven commitment to reform and continuing ethnic tensions. In many countries the privatization process is incomplete, and loss-making enterprises and banks continue to operate and accumulate tax arrears, weakening governance. Progress has been limited to date in establishing the legal and social institutions that underpin effective markets and lay the foundation for private investment. Recent increases in ethnic tensions in FYR Macedonia and Kosovo underscore the importance of political stability to the development of the region.

Accession to the European Union

Expected accession to the European Union (EU) has been an important factor strengthening financial stability and underlying economic reform efforts in Central and Eastern Europe. At its intergovernmental council meeting in December 1997, the EU identified 10 "accession countries" as candidates for early membership, and in March 1998 began initial accession negotiations with 5 of them (the Czech Republic, Estonia, Hungary, Poland and Slovenia).[1] In December 1999, at the Helsinki Summit, the EU decided to initiate accession negotiations with the remaining 5 accession countries (Bulgaria, Latvia, Lithuania, Romania and the Slovak Republic), with progress through the negotiations as quickly as warranted by each country's own efforts to prepare for accession. In addition, the Summit committed the EU to be ready to decide from the end of 2002 on the accession of candidates that fulfill all necessary criteria.

The EBRD, European Commission and World Bank have signed a memorandum of understanding setting out the basic principles for collaboration in supporting projects that will assist all accession countries in meeting the requirements of the EU. In particular, all 10 accession countries face specific requirements for investment in infrastructure to meet the requirements of the EU's *acquis communautaire*, or inventory of laws and standards. The EBRD will actively support projects where its mandate and EU accession requirements overlap.

The EU has also held up the prospect of EU membership for the countries of Southeastern Europe through the Stabilisation and Association Process. Under this process the EU will negotiate Stabilisation and Association Agreements with democratic, reform-minded countries in the region. The Agreements offer the prospect of better trade access, increased assistance for education and institution building, co-operation in the areas of justice and home affairs, formal political relations with the EU and, one day, membership in the EU. Thus far the EU has entered into negotiations to establish agreements with FYR Macedonia, Albania and, most recently in 2000, with Croatia. It is hoped that the prospect of EU membership will spur reform efforts in Southeastern Europe as it has done in Central Europe and the Baltic States.

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[1] The 10 accession countries are Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia. The EU has negotiated accession partnerships with all 10 countries.

The Non-Russian CIS

The real exchange rate realignments that occurred in 1998-99 throughout much of the non-Russian CIS are a key factor behind the stronger growth experienced by most countries in the region in 2000. For the first time since the start of transition, Ukraine saw real GDP increase (6 per cent) as the depreciation of its currency in 1998-99 resulted in significant import substitution that stimulated domestic production and strengthened exports. This effect has been repeated in numerous countries across the region. The sharp real depreciation of many currencies in the CIS, while good for competitiveness in the short term, has caused the debt burden of many countries to increase dramatically, as much of what they owe is denominated in foreign currency. As a result, the ability of a number of the smaller economies in the region, such as Georgia, Kyrgyzstan, Moldova and Tajikistan, to service their debt is increasingly in question. In contrast to most of the other countries in the non-Russian CIS, Georgia and Uzbekistan saw real GDP growth slow in 2000.

For oil-producing countries such as Kazakhstan and Azerbaijan, high oil prices have helped buoy growth and improve external and fiscal accounts, contributing to a rapid return to relative macroeconomic stability. Similarly, the strength of other commodity prices has helped to buoy growth in the non-Russian CIS as a whole, where commodities represent over 50 per cent of exports in all but three countries. Relative exchange rate stability in 2000, as well as moderating inflation in the non-Russian CIS and stronger growth in Russia, has supported the rebuilding of intra-CIS trade links disrupted by the Russian crisis.

As with Russia, the non-Russian CIS countries face significant challenges in terms of their central-planning legacy, the extent of structural distortions and the limited capacity of state institutions, and they continue to lag considerably behind countries in Central Europe in implementing structural reforms (see table on page 9). Nonetheless, difficult structural reforms have begun in a number of countries, notably Azerbaijan and Georgia, and they have now experienced a few years of growth. In 2000 Georgia and Tajikistan achieved the greatest progress in reform, as the recovery from civil conflicts provided an opportunity to move forward on long-delayed price and trade liberalization, small-scale privatization and competition policy. In contrast, Belarus, Uzbekistan and Turkmenistan have yet to embark on comprehensive liberalization and privatization reform programs.

Transition Report 2000

The *Transition Report* is an annual publication of the EBRD that charts the progress of transition from a command to a market economy in each of the EBRD's 26 countries of operation. Each year the report has a special theme. In 2000 it examines the human dimension of transition by taking a closer look at how employment, skills, poverty and inequality have evolved over the past decade of transition.

A key conclusion of the report is that the countries that have made the most progress on structural reforms have had better outcomes in terms of labour market performance, economic inequality and poverty. In Central Europe and the Baltic States unemployment, poverty and inequality increased early in the reform process. However, the relatively rapid restructuring of enterprises that allowed the development of new firms and activities soon created new labour market opportunities. At the same time, the development of effective social assistance programs facilitated people's transition to the changing structure of the economy and helped reinforce popular commitment to the reform process. Importantly, as the report notes, the development of competition in product and labour markets has created an incentive for firms and people to invest in skills development. Ongoing investments in education and physical capital will be essential to improve living standards in the face of globalization and the rapid adoption of new technologies abroad.

In contrast, in the CIS and Southeastern Europe, the progress has been generally less positive. Enterprise restructuring has proceeded slowly, impeding the emergence of new firms and activities in a significant manner. In addition, the expectation by many CIS governments that the large enterprises that made up the bulk of the former planned economy would continue to provide a large share of social safety nets, despite the fact that these enterprises no longer have the means or the inclination to do so, has resulted in widespread poverty among the unemployed and among workers not paid for months. The resulting growth of an informal economy has weakened the ability of governments to put in place the types of safety nets that are required for restructuring to proceed. The human cost of these reform failures, as the report notes, has been high. Over a third of households in Russia have fallen into poverty, and inequality and corruption have grown. The report also indicates that there has been little new investment in plant, equipment or employees in the CIS. Skills have depreciated and the quality of the workforce has declined. This, the report notes, does not bode well for future improvements in standards of living.

The report concludes that effective policies to alleviate or prevent poverty require improvements in the capacity of the EBRD's countries of operation to create wealth and employment. This will require improvements in the business and investment climate. The report also concludes that an effective social safety net is needed not only on moral grounds, but also for the political viability of the reform process.

2000 FINANCIAL PICTURE

Financial Highlights

- The Bank posted a strong recovery in profitability in 2000 as profit after provisions increased to 152.8 million euro (C$215 million), up from 42.7 million euro in 1999.[1]
- Provision charges totalled 174.3 million euro (C$246 million) in 2000, well below the 2000 budgeted level of 210 million euro, due to better-than-anticipated portfolio performance as well as lower-than-expected disbursements.
- Operating income was 519.2 million euro (C$731.6 million), up from 376.4 million euro in 1999, primarily due to higher interest income and net fee and commission income, as well as strong profits from the sale of share investments.
- The Bank signed new commitments of 2.7 billion euro (C$3.8 billion) in 2000 (including 200 million euro of restructured commitments), a 24-per-cent increase over 1999 and close to the high end of the projected range for 2000. These commitments will provide funding to 95 projects.
- However, disbursements rose by only 3 per cent to 1.5 billion euro (C$2.1 billion), below the 1.9 billion euro projected for 2000, as potential debtors or investees failed to meet disbursement conditions for a variety of reasons.
- New commitments going to Russia more than doubled in 2000, to 579 million euro (C$816 million) from 217 million euro in 1999. Russia's share of annual business volume rose to 22 per cent in 2000 from 10 per cent in 1999, but remained well below its pre-crisis peak of nearly 800 million euro, or some 33 per cent of annual business volume. In early and intermediate transition countries[2] annual business volume rose to 1,060 million euro (C$1,494 million), or 40 per cent (down from 48 per cent in 1999), while in advanced transition countries annual volume rose to 1,034 million euro (C$1,457 million), or 39 per cent of the total.
- The Bank mobilized 1.9 euro (C$2.7) in additional financing for every euro that it invested in 2000, down slightly from 2.2 euro in 1999.
- Equity investments represented 23 per cent of annual business volume in 2000, down from a record 31 per cent in 1999, when the EBRD participated in a number of bank privatizations.
- Administrative expenses, denominated in pounds sterling (the currency in which most of the Bank's expenses accrue) were well within budget at £129.5 million.
- The results for 2000 re-established positive reserves,[3] which reached 65.9 million euro (C$93 million) at the end of 2000, nearly reversing the financial setback of 1998.

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[1] Provisions are subtracted from operating income along with other expenses. For private sector projects, which comprise the bulk of the EBRD portfolio, provisioning follows a risk-based approach. Management continually reviews the portfolio to ensure that the current value of loans and investments reflects management's best estimate of the recoverability of Bank assets.

[2] Advanced transition countries include Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic and Slovenia. Early and intermediate transition countries include the balance of the EBRD's countries of operation, excluding Russia: Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, FYR Macedonia, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Romania, Tajikistan, Turkmenistan, Ukraine and Uzbekistan.

[3] Reserves are Bank capital set aside to cover unexpected losses. The Russian financial crisis drove the Bank's reserves into deficit as it provisioned heavily to cover possible investment losses.

The strong recovery in the EBRD's profitability in 2000 is encouraging. It reflects stronger growth in the Bank's countries of operation as well as enhanced project monitoring by the Bank. The economic recovery in the Bank's countries of operation has helped to boost earnings – net interest income, dividends and equity earnings – while strengthened project monitoring has helped ensure potential problems are addressed well before investments become impaired and stop generating income. Importantly, the return to profitability has permitted the Bank to rebuild its reserves (shareholder capital set aside to cover unanticipated events), which were depleted at the time of the Russian crisis, when the Bank provisioned heavily to cover expected losses. The recovery of reserves means the Bank is better placed to weather future shocks. This is important, as shareholders provided a capital increase in 1996 on the understanding that there would be no further need for capital replenishments.

Despite the improved profit performance in 2000, the low level of disbursements is somewhat worrisome. To generate income sufficient to cover operating costs in the future, the Bank's earning asset base must grow. The Bank contributes to the growth of its earning asset base by disbursing funds to sound projects that contribute to transition and generate a stream of earnings. With the maturation of the Bank's portfolio, the earning asset base is under downward pressure as loans are repaid in full and equity positions liquidated. Increasing the earning asset base will require the Bank to disburse sufficient funds to more than offset this decline. However, with the increasing access of the advanced transition countries to private capital and financial markets, and the poor investment climate in many of the CIS countries, disbursing funds to quality projects will be challenging.

In the high-risk environment in which the Bank operates, where most countries of operation remain well below investment grade, managing risk effectively is essential for long-term financial viability. As a result, in 2000 the EBRD undertook a thorough review of its risk management and analysis techniques, culminating in the development of a state-of-the-art risk management model. During the course of 2000 this model was used to review the way the Bank provisions its investments. The review resulted in a strengthening of the Bank's provisioning policy.

During 2000 the EBRD also began a review of its capital resources. The Bank's Articles of Agreement mandate such a review every five years. The last review was undertaken in 1995 and culminated in a decision by Governors to double the Bank's capital at the 1996 annual meeting. The preliminary results of the 2000 review indicate the Bank has sufficient capital to fulfill its mandate in the medium term. Therefore, the focus of the 2000 review is on using the Bank's capital in the most effective and efficient way possible. Governors will discuss the results of the 2000 capital resources review at their Annual General Meeting in London in April 2001.

Administrative Efficiency and Cost-Effectiveness

The EBRD's general administrative expenses in 2000 expressed in pounds sterling were well within budget and comparable to those for 1999, reflecting continuing budgetary discipline, effective cost controls and a proactive cost-recovery program. As a result of the strengthening of the pound sterling against the euro during the year, the Bank's general administrative expenses, when expressed in euro, were 192.1 million euro (C$270 million), or 11 per cent above their 1999 level. The Bank's entry into exchange rate contracts on foreign exchange markets partly mitigated the impact of euro depreciation on administrative expenses in 2000.

In 2000 the Bank was relatively successful in containing costs despite increased resource demands stemming from enhanced portfolio monitoring, and despite the Bank's increasing focus on resource-intensive activities, such as micro, small and medium enterprise finance, and the investment climate. The ongoing transfer of country operations to the region of operation also contributed to one-off cost pressures in 2000. To ensure the future cost effectiveness of Bank operations and to improve the basis for shareholder analysis and decision making on budget matters, the Bank undertook a comprehensive review of budget planning and processes in 2000. The review resulted in the Bank's decision to formulate a corporate scorecard, whose annual performance benchmarks will be agreed with management and serve as a yardstick against which to judge staff performance. The review also resulted in improved cost allocation. These measures enhance the transparency and accountability of the budget process for shareholders and provide for better cost control.

Nonetheless, operating expenses relative to operating income (excluding capital gains) are high, underlining the importance of continued cost control as well as the need for continued productivity enhancements that will enlarge the size of the investment portfolio and the Bank's earning asset base.

Canadian Priorities in 2000

Canada is a strong supporter of the Bank's medium-term operational priorities, which are premised on the central importance of creating and strengthening the institutions – administrative, behavioural and financial – that ensure markets work well. This is the key challenge facing all the countries in transition, but particularly those in the CIS and Southeastern Europe, over the next decade. In this regard, Canada supports the Bank's focus on:

- developing sound financial sectors linked to the needs of enterprises and households;
- providing leadership for the development of micro lending and small and medium-sized enterprises (SMEs);
- developing market-based and commercially oriented infrastructure;

- demonstrating, through selected examples, effective approaches to restructuring viable large enterprises;
- taking an active approach to equity investment to improve corporate governance; and
- engaging governments in policy dialogue to strengthen institutions and improve the investment climate.

In all of these areas the EBRD is committed to working closely and co-operatively with other international financial institutions and donors in the region. Canada encourages this approach. It believes that the way in which the EBRD works with other international financial institutions and donors determines to an important extent its effectiveness in moving forward the transition to a market economy. A co-ordinated approach is particularly important in view of the impact that policies, market-supporting institutions and other aspects of the investment climate have on the EBRD's ability to develop sound projects, and in view of the contribution that other international financial institutions, regional development banks and donors can make to improving the investment climate. Indeed, the added policy leverage that comes with co-ordination can be decisive in determining whether EBRD projects are successful.

Private Sector Development

Canada is a strong proponent of the private sector work of the Bank, recognizing that a strong private sector is key for the successful transition to a market economy. About 78 per cent of the EBRD's new commitments in 2000 were for private sector operations, compared to about 75 per cent in 1999.

The Private Sector Focus of the Bank

The European Bank for Reconstruction and Development Agreement Act requires that the Bank achieve at least a 60/40 ratio (the so-called "portfolio ratio") in its private/public sector activities, both globally and in individual countries.

The global portfolio ratio was first satisfied in 1994. By the end of 2000 nearly 71 per cent of the Bank's cumulative outstanding commitments were for private sector activities. However, progress in reaching the individual country ratios has been mixed. The Bank's articles require it to attain the 60/40 private/public split five years after the approval of the Bank's first operation in that country. This deadline was reached in all but one country in 2000. Nonetheless, at the end of 2000 the private/public sector ratio was attained in only 12 of the Bank's 26 countries of operation.

The shortfall in meeting the ratio has been most evident in early transition economies, where privatization has developed relatively slowly and where the Bank has often been active in developing public infrastructure critical to the development of a strong private sector. Many early and intermediate transition economies still have relatively small and immature private sectors. The Bank continues to pursue strategies in each country to reach at least a 60-per-cent private sector ratio.

Supporting micro, small and medium-sized enterprises – An important part of the EBRD's work with the private sector is its support of micro, small and medium-sized enterprises, which are potentially important engines for job creation and growth, and therefore poverty reduction, in the region. The Bank's strategy for the sector is founded on three pillars: finance, investment climate and the development of support networks for SMEs. The strategy explicitly recognizes that the poor investment climate – and not just limited access to financing – is an important impediment to the development of the sector. The strategy therefore calls on the EBRD to work to identify and promote the removal of the main obstacles to SME growth, as well as to encourage the development of strong business associations. Canada views developing the SME sector as a means for developing a "constituency for reform" in the transition economies that can act as a counterweight to powerful vested interests that benefit from weak state governance.

... through dedicated micro-credit institutions – In 2000 the EBRD continued to expand its support to SMEs via the dedicated micro-credit institutions it has established in conjunction with strategic investors. Most of these institutions were established in the wake of the Russian crisis, which underlined the risk of doing business with local financial institutions in countries where financial regulation and supervision are weak and systemic risks high. By the end of 2000 the EBRD had participated in establishing micro-credit institutions in 13 countries, most notably in Russia. The strong shareholder base of these institutions, along with their commitment to transparency and strong corporate governance, make them models for local financial institutions in the region. During 2000 the Small Business Credit Bank (KMB-Bank) in Russia, in which the EBRD has an equity position,[6] granted over 4,600 micro and small loans worth almost US$60 million with arrears (30 days past due) of just 0.6 per cent of the portfolio. The strong performance of the KMB-Bank led the EBRD to participate in its recapitalization in December 2000. In 2000 alone the EBRD's micro and small enterprise lending programs and institutions reached over 50,000 borrowers, granting US$244.5 million in loans with an average size of US$5,000.

... through credit lines to banks – In 2000 the EBRD continued to extend credit lines to local banks to on-lend to micro, small and medium-sized enterprises. Notably, the EBRD committed an additional 75 million euro to the regional SME Facility set up in 1999 with the EU to encourage local banks and private equity funds in the 10 EU accession countries to expand SME operations. In addition, the EBRD's second credit line for SMEs in Ukraine, worth US$88 million, became operational in 2000. It will deal only with local banks that have a strong reputation and relationship with the EBRD. This follows the completion of the Bank's first SME credit line in Ukraine, which disbursed US$132 million via 10 participating banks. The EBRD also extended credit lines to banks in Bosnia and Herzegovina, Bulgaria, Croatia, Estonia and Poland.

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[6] In 1999 the Russian Project Finance Bank, in which the EBRD had an equity position, was reorganized and recapitalized into a specialized micro and small lending institution, the KMB-Bank, through a US$3-million equity infusion from the EBRD.

The Russia Small Business Fund

Established by the EBRD as a pilot project in 1993 following a request by the G-7, the Russia Small Business Fund (RSBF) was financed jointly by the EBRD, the G-7, the EU and Switzerland to promote small and micro enterprise lending in Russia. At its inception the Fund was valued at US$300 million.[1] The Fund operates by lending to local banks that then on-lend to local SMEs. The RSBF also has a technical assistance facility whereby partner Russian commercial banks receive assistance from Western experts. Canada, through the Canadian International Development Agency (CIDA), contributed US$8.1 million (C$12.2 million) to the program, including US$2 million in 1998.

In 2000 the RSBF continued its progress in recovering from the 1998 Russian financial crisis, which constrained many of its participating banks. By the end of the year the Fund had bounced back to pre-crisis lending volumes, which continue to expand. The development of the Russian Small Business Credit Bank (KMB-Bank) by the EBRD and the branch expansion it has undertaken throughout Russia has greatly aided the process of both increasing lending volumes and bringing much-needed competition into the Russian financial sector in the communities served.

In 2000 the RSBF granted a total of 13,840 micro, small and medium-sized enterprise loans worth US$122 million, bringing the cumulative number of loans to almost 45,000 since the program's inception in 1994, with a value of US$502 million. Arrears (more than 30 days)[2] stood at 2.25 per cent at the end of 2000. The RSBF model has been replicated by the EBRD in Moldova, Bosnia and Herzegovina, Kazakhstan, Ukraine and the Baltic States.

[1] In 1995 the G-7 committed US$150 million to the US$300-million RSBF. The G-7 contribution was split between an investment fund, which assumed a "first loss" position, and a technical assistance fund. Canada's contribution was for both funds.

[2] This includes arrears only for banks that are active under the program.

. . . through equity investments – The EBRD also extended its equity support to SMEs through investments in private equity funds.[7] These funds are the most significant source of equity finance for SMEs in the region. By the end of 2000 the EBRD had committed 802 million euro to 48 private equity funds with a total capital of 4.1 billion euro. It made six new investments in 2000. The EBRD also invests in donor-sponsored funds, which provide a combination of equity capital and grant financing to support investments in higher-risk countries. By the end of 2000 the EBRD had committed 355 million euro to 29 funds with a total capital of 728 million euro.

[7] These are supported by private institutions and fund managers.

Private Sector Development in Southeastern Europe

The EBRD continued to expand operations in Southeastern Europe, guided by its South Eastern Europe Action Plan (SEEAP), which seeks to promote investment and assist in the economic recovery of the region. The SEEAP covers the EBRD's countries of operation in the region – Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FYR Macedonia and Romania. As of January 2001 it also includes the Federal Republic of Yugoslavia (Montenegro, Serbia and Kosovo).

Under the SEEAP, EBRD investments are to focus on developing commercial approaches to infrastructure (such as telecommunications, airports, and municipal and environmental infrastructure), SMEs and micro enterprises, and the financial sector. This focus reflects the transition challenges facing the region – crumbling infrastructure, a weak industrial asset base, mostly small, fragile banks and pervasive problems of economic governance. In addition, EBRD operations aim to develop regional links. The EBRD's focus is supported by the Stability Pact for South Eastern Europe,[1] which is an umbrella initiative under which multilateral and bilateral assistance to the region is being co-ordinated.

In 2000 the EBRD provided funding totalling 524 million euro to member countries in Southeastern Europe. Indeed, since 1992, the EBRD has been responsible for nearly 20 per cent of the foreign direct investment in the region (this includes investment by partners, as it is reasonable to assume that a significant part of this investment would not have occurred or would have been much more modest had the Bank not been present to mitigate risk). Given the low level of income of the countries in Southeastern Europe, as well as balance of payments problems in some, the EBRD drew on concessional co-financing to support some projects. In 2000 CIDA established a Trust Fund to provide technical co-operation funds and co-financing in support of EBRD projects. Thus far CIDA has provided support to projects in the municipal infrastructure and transportation sectors. Rebuilding infrastructure is an important element for the private sector development of the region.

In 2000 the EBRD also continued to undertake activities in Kosovo. Most notable was its participation, along with the International Finance Corporation,[2] in the licensing of the first bank in Kosovo, the Micro Enterprise Bank, which will service the financial needs of micro, small and medium-sized enterprises. Throughout 2000 the EBRD's activities in Kosovo could not be funded from ordinary capital resources, as the Bank's Articles of Agreement limit such funding to members. Therefore, Bank operations in Kosovo were financed by co-operation funds provided by donor governments or bilateral agencies. With the membership of the Federal Republic of Yugoslavia in the Bank in January 2001, future activities in Kosovo can be financed from the Bank's capital, as can activities in Montenegro and Serbia.

[1] The Stability Pact for South Eastern Europe is an EU, G-8 and international financial institution initiative that includes the EBRD. It was established in 1999 to promote the progressive integration of Southeastern Europe into EU structures by promoting regional co-operation, security and development.

[2] The International Finance Corporation is an international financial institution that promotes private sector investment in developing countries by providing financing to the private sector in these countries. It is part of the World Bank Group.

Activities in the Financial Sector

Financial Sector Policy – The EBRD's financial sector policy guides its approach to the financial sector. The policy takes a country-specific approach to financial sector development, focusing on the need to promote confidence and competition in an independent financial system. The EBRD seeks to strengthen confidence in the sector primarily by helping to improve local institutions' governance and business practices. It also works to try to improve financial supervision and regulation, though its activities here are constrained by its investor role in the sector and potential concerns about conflict of interest. Nonetheless, as a reputable foreign investor in the sector, the EBRD offers important insights on supervisory and regulatory requirements in the sector, which it shares with other international financial institutions operating in the region and with governments. To address competition and independence, EBRD investments attempt to increase the diversity of institutions and services available (particularly to the private sector and SMEs), facilitate foreign direct investment, and strengthen the commercial orientation of state-owned financial institutions, particularly in preparation for privatization.

In 2000 the EBRD committed financing to 32 financial sector operations, bringing total EBRD exposure to the financial sector region-wide to 4.8 billion euro.

Banking Sector Activities – In 2000 the Bank completed its first large-volume transaction in the Russian banking sector since the 1998 crisis with a US$10-million participation in the recapitalization of Russia's fourth largest bank, International Moscow Bank. With majority ownership in the hands of a consortium of Western banks, the International Moscow Bank offers good opportunities for the EBRD to advance its financial sector policy objectives. By the end of 2000 the EBRD had signed loans valued at 2.5 billion euro to the banking sector and taken 831 million euro in equity positions in local banks. In most cases, where the EBRD holds an equity stake in a local financial institution, it is represented on the supervisory board of the institution, where it promotes management accountability, good corporate governance, sound banking practices and appropriate environmental reviews and procedures. Participation in bank privatizations is a key factor behind equity investments in early and intermediate transition countries. In 2000 the Bank participated in the first financial sector privatization in Albania.

Non-Bank Financial Institutions – During 2000 the EBRD also stepped up its activities in the non-bank financial sector, especially in the EU accession countries, predominantly by taking minority equity stakes in insurance companies and asset management/mutual fund companies, and expanding its support for leasing activities. A total of 10 new transactions were signed in the non-bank financial sector during the year, with new commitments of 70 million euro. The EBRD is one of the largest financial investors in this sector, with investments in local asset management and mutual fund companies becoming

increasingly important as voluntary pension sectors in the Bank's countries of operation develop. By the end of 2000 the Bank had investments in the non-bank financial sector in nearly all the countries in the region, where necessary institutional and regulatory regimes had been or were in the process of being introduced.

Environment

Support for the environment remained a key priority in 2000, reflecting the Bank's mandate to ensure sustainable long-term development in member countries. The EBRD is directed by its statutes to "promote in the full range of its activities environmentally sound and sustainable development." The Bank fulfills its environmental mandate principally through its projects. In recognition of its wider role, it contributes to international initiatives such as the "Environment for Europe" process, including the Environmental Action Plan for Central and Eastern Europe, the Danube River Basin Strategic Action Plan, and the Helsinki Commission and the Global Environment Facility, for which it became an executing agency in 1999. Within the framework of its mandate, the EBRD supports relevant multilateral and regional agreements on environment and sustainable development, including the Framework Convention on Climate Change and the measures agreed to in the Kyoto Protocol.

The EBRD applies environmental due diligence to all its investment and technical co-operation operations. Project sponsors are required by the Bank to undertake environmental impact assessments, analyses and audits that address potential environmental, health and safety, and socio-economic impacts of a project. Environmental impact assessments and environmental analyses are conducted when potential impacts are significant. Environmental audits are performed when a project relates to an existing operation. In some cases both an audit and assessment/analysis are required.

The EBRD also requires local financial intermediaries, through which it channels funds to micro, small and medium-sized enterprises, to adopt appropriate environmental policies and procedures. To ensure that environmental considerations are being adequately taken into account by local financial institutions, the EBRD hosted two conferences in 2000 for environmental experts from international financial institutions to discuss environmental issues related to intermediary financing. As a result, working groups have been established to develop joint environmental awareness and due diligence training programs for financial intermediaries; improve the nature and efficiency of reporting mechanisms as a tool for better environmental monitoring; and develop effective means of environmental conditionality in the terms of legal agreements between international financial institutions and their local partners, and local partners and their clients.

In 2000, 10 environmental projects were signed with a total EBRD commitment of 228 million euro. The EBRD also conducted 33 environmental analyses, including 3 environmental impact assessments and 24 environmental audits on projects approved by the Board of Directors in 2000.

Countries at more advanced stages of transition, especially those seeking accession to the EU, are now channelling more resources into investments to improve environmental conditions. In addition, increased attention is being given to improving the provision of essential municipal services, such as district heating, water supply and urban transport, as the availability and quality of these services are critical to underpinning economic development.

Municipal and Environmental Infrastructure

Improving the environment is a key objective of EBRD operations in the municipal and environmental infrastructure sector. EBRD investments in this sector focus on upgrading local facilities, such as municipal waste-water treatment plants, and on raising the service levels of municipal and local utility companies. As well as helping the Bank's countries of operations comply with European environmental standards, these investments assist in advancing the transition to a market economy. Reducing costs and increasing the reliability of municipal services stimulates the development of commercial and industrial enterprises. At the same time, improvements in living conditions, through greater access to clean water and sanitation services, improve public health and increase public confidence in the transition process and in ongoing reform efforts.

The EBRD continued to pioneer operations in this area in 2000. Over the last few years it has increasingly relied on municipal as opposed to sovereign guarantees in this sector, providing local governments with important new financial opportunities and responsibilities. In 2000 the Bank pushed the envelope even further by financing its first long-term local currency loan to a municipal water and sewerage company without a financial guarantee from the municipality. As well as having important demonstration effects about the creditworthiness of the municipal company, the absence of a financial guarantee from the municipality leaves the latter with greater financing capacity for investments in non-revenue sectors, such as housing, education and roads. The EBRD's operations policy for municipal and environmental infrastructure emphasizes private sector involvement as well as the development of appropriate regulatory structures and energy efficiency.

By the end of 2000 the EBRD had committed almost 1 billion euro to municipal infrastructure and services projects in about 90 municipalities in 18 countries, thereby improving services for 30 million people.

Energy Sector Investments Improve the Environment

Most of the EBRD's countries of operation suffer from severe economic and environmental problems caused by inefficient and polluting energy systems and inadequate pricing dating back to the communist era. In 2000 the EBRD reviewed and updated its Energy Operations Policy, which sets out how the Bank intends to promote energy efficiency through its operations. One of the revised policy's key objectives is to improve environmental performance, including meeting climate change objectives and supporting renewable forms of energy. In 2000 the Bank committed nearly 17 million euro to projects in the energy sector, bringing cumulative commitments in this sector to 188 million euro. This involvement has benefited the environment in the countries of operation through reductions in the level of atmospheric emissions. An inventory of the Bank's energy projects until 1997 (most recent data available) shows a net annual saving of around 5 million tons of carbon dioxide. The Bank also ensures through conditionality in its loans that all borrowers improve overall environmental management and health and safety practices.

The EBRD and Nuclear Safety

Canada and other G-7 countries have been working closely with the EBRD to improve nuclear safety in countries of Central and Eastern Europe and in the former Soviet Union. To facilitate this work, Canada has contributed to the Nuclear Safety Account (NSA), which the EBRD administers on behalf of the G-7 countries and other contributors. The NSA is used primarily for making essential safety improvements to older-generation, Soviet-built reactors as part of a comprehensive program for their early decommissioning. As of December 31, 2000, pledges to the NSA totalled 289 million euro (C$420.7 million). Canada has contributed C$19.5 million.

On behalf of the G-7, the Bank has agreed to administer the US$768-million Chernobyl Shelter Fund for securing the sarcophagus around the destroyed – by nuclear accident – Unit IV reactor in Ukraine. The G-7 nations, the EU and other countries have pledged US$716 million, of which Canada has pledged a contribution of US$33 million.

In 2000 three International Decommissioning Support Funds were created to assist with the decommissioning of unsafe nuclear reactors in Lithuania (Ignalina Units 1 and 2), the Slovak Republic (Bohunice VI Units 1 and 2) and Bulgaria (Kozluduy Units 1–4). The 500 million euro in grant funds will assist these countries with the early phase of decommissioning as well as in restructuring, upgrading and modernizing the energy production, transmission and distribution sectors, and improving energy efficiency more generally.

In December 2000 the EBRD approved a US$215-million loan to Ukraine's nuclear operator for the completion and safety upgrades to the Khmelnitsky Unit 2 and Rovno Unit 4 (K2R4) nuclear power plants. Canada supported this project at the EBRD Board. Canada considers that this project will contribute to a substantial improvement in nuclear safety and to energy sector reform in Ukraine. EBRD financing is conditional on the permanent closure of the older Chernobyl 3 reactor; Unit 3 was closed on December 15, 2000. In addition, EBRD financing ensures K2R4 will be completed to Western safety standards and is conditional on assurances that nuclear safety standards in Ukraine will be further improved and properly maintained.

Addressing Corruption and Poor Governance

The Bank's medium-term priorities include addressing issues of corruption and governance, as these are significant factors influencing the investment climate in the Bank's countries of operation. Key efforts in this regard include strengthening the policy dialogue with governments by achieving joint agreement on necessary improvements. Important high-level venues for this dialogue are the Foreign Investment Advisory Councils in Russia, Ukraine and Kazakhstan. They bring together government ministers, political leaders from the Bank's countries of operation, representatives of the international business community and high-ranking EBRD officials twice yearly to discuss how to improve the investment climate in the countries.

The transition countries, like most emerging economies, face significant challenges in improving transparency and governance. The Bank reviews on an annual basis, as required by its statutes, each country's progress towards multi-party democracy and pluralism. These principles, effectively implemented, contribute to transparency in government policy making and act as a check on corruption. In 2000, following a review of Turkmenistan, the Bank moved to curtail new public sector lending there until political reforms were forthcoming and the government demonstrated a commitment to economic reform. Until then operations will be limited to private sector projects that can be relatively insulated from government economic policies and that contribute to building a constituency for reform. The Bank has similarly limited operations in Belarus. Canada fully supports this approach.

The EBRD seeks to improve governance and transparency largely through the projects it undertakes. Equity investments have been an important tool in this regard. The Bank's participation on the board of directors of companies in which it invests has been instrumental in improving the transparency of their accounting and business practices and their respect for minority shareholder rights. It is hoped that the success of these companies will demonstrate the importance of applying similar practices more broadly in the region. In addition, all Bank counterparts are examined to ensure they meet the highest standards of business practice. The Bank now routinely seeks the services of forensic accountants and other specialized firms to perform integrity checks on potential investee companies and their management and shareholders. The EBRD's public procurement rules underline, for those doing business with the EBRD, the standards of ethics and conduct required during the procurement and execution of EBRD-financed projects.

The Bank's work in the area of legal transition also plays an important role in addressing issues of corruption and poor governance. Under the Legal Transition Programme, the Bank continued to work to improve the legal environment in its countries of operation by fostering interest and advancing legal reform in six areas: bankruptcy, company law/corporate governance, concessions, financial market regulation, secured transactions and telecommunications. In addition, the Bank continued to participate in

international standard-setting efforts, including the World Bank's Insolvency Initiative, which seeks to develop international principles of bankruptcy, and the Financial Stability Forum's efforts to co-ordinate the development and implementation of international financial standards. The Bank also initiated a project with the Russian Federal Commission for the Securities Market to develop a Corporate Governance Code. To promote transparency, the EBRD publishes an annual survey of the extensiveness and effectiveness of various commercial laws in the region in its legal journal, *Law in Transition*.

INSTITUTIONAL DEVELOPMENTS

Enhancing Transparency and Accountability and Strengthening Internal Governance

Public Information Policy – In 2000 the EBRD modernized its Public Information Policy to broaden significantly the scope of information that the Bank makes available to the public. The policy is based on the presumption that information about Bank activities should be made public in the absence of a compelling reason for confidentiality. The following documents are now made available to the public with commercially sensitive information deleted as required: draft sectoral policies (for public comment); final sectoral policies; Board-approved country strategies following consultation with the country concerned; summaries of medium- and long-term operational strategies; executive summaries of environmental impact assessments for public and private sector projects; and reports on public sector projects (on a request basis). The new policy also requires management to report annually to the Board on the implementation of the Public Information Policy. These findings are made available on the Bank's Web site.

Canada welcomes the new policy as a marked improvement over the previous public access and disclosure of information policy. The new policy is consistent with the call by G-7 finance ministers in Fukuoka, Japan, in 2000 for higher standards of transparency and accountability for multilateral development banks. In all international financial institutions in which it is a member, Canada has been at the forefront of efforts to improve transparency and accountability.

NGO Liaison Officer – A non-governmental organization (NGO) Liaison Officer was appointed in 2000 to serve as a point of contact between the Bank and the NGO community. The position is presently part-time and on a consultancy basis. The Bank, at the request of the Board, intends to convert the position into a permanent post within the next six months. The NGO Liaison Officer is located in the Communications Department, which from February 2001 has been headed by a Canadian. It is hoped that over the course of the next year, the role of the Liaison Officer will take on greater importance in all Bank operations.

Chief Compliance Officer – In March 2000, in an effort to further strengthen internal governance, the EBRD appointed its first Chief Compliance Officer, responsible for promoting good governance within the Bank and ensuring that all employees respect the highest standards of business integrity. During the course of the year the Compliance Officer identified a number of areas where attention should be focused to avoid possible breaches of integrity. These include money laundering, confidentiality, insider trading and conflicts of interest. The Compliance Officer has developed a training program for EBRD nominees to boards of directors of enterprises in which the Bank has invested to ensure nominees are fully aware of their responsibilities and possible actions that could breach the Bank's integrity. Further initiatives are being developed. The decision to appoint a compliance officer should help provide guidance to employees on appropriate behaviours and strengthen Bank policies and procedures to prevent breaches of integrity.

Changes in Presidency and Senior Management

Resignation of President Köhler – In 2000, after a little more than a year at the helm of the EBRD, Horst Köhler stepped down as President of the EBRD to assume the position of Managing Director of the International Monetary Fund. During his term at the EBRD, Mr. Köhler introduced a number of operational and organizational changes in response to the Russian financial crisis and the experience of 10 years of transition.

Appointment of President Lemierre – Mr. Jean Lemierre was unanimously elected as the new President at the Annual General Meeting in May 2000. Mr. Lemierre's appointment follows a distinguished career in the French public service, where he held the position of Director of the French Treasury Department, the top position there, and was France's G-7 Deputy. Under Mr. Lemierre's leadership the Bank is assigning greater importance to the development aspects of its mandate, while retaining its project-centred private sector focus. This has meant an increasing focus on how Bank operations, private and public, contribute to improving living conditions and development in the region. Since his election President Lemierre has met with the heads of the World Bank, the International Monetary Fund and other regional development banks to build on their complementarities.

Senior Management Appointments – The Bank appointed a new Vice President of Personnel and Administration in 2000. Mrs. Hanna Gronkiewicz-Waltz, the former President of the National Bank of Poland (Poland's central bank), assumed her responsibilities in January 2001. The new VP will face significant organizational challenges to ensure the EBRD meets the transition challenges of the next decade. The Vice President, Evaluation and Operational and Environmental Support, Joachim Jahnke, was re-appointed for a two-year term. In addition, University of Cambridge professor William Buiter took up the position of Chief Economist in June.

New Members

The Bank expanded its membership to include Mongolia in October 2000 and the Federal Republic of Yugoslavia in January 2001. Although Mongolia, an economy in transition from central planning, is now a member of the EBRD, it is not eligible to be a country of operation. According to the Articles of Agreement establishing the Bank, it can conduct its operations only in countries from Central and Eastern Europe and the former Soviet Union. Mongolia is widely viewed to be part of Asia, not Europe. The Federal Republic of Yugoslavia, by virtue of its geographic position within Europe, is a recipient country for Bank operations.

Managing Canada's Interests

Role of Governors – The highest authority in the Bank is the Board of Governors. Member countries are represented by a Governor and an Alternate Governor. The Honourable Paul Martin, Minister of Finance, is the Canadian Governor and Mr. Gaëtan Lavertu, Deputy Minister of Foreign Affairs, is the Alternate Governor.

Role of the Board of Directors – The Board of Directors is responsible for the general operations of the Bank. The Board is composed of 23 members, of which 4 are non-European members. Canada is the third largest non-European shareholder, after the United States and Japan, and by virtue of its share has the right to elect its own Director. Canada also represents Morocco at the Bank. The Canadian Director is Patrice Muller. The Minister (Economic/Commercial) at the Canadian High Commission in London, Tom MacDonald, is the non-resident Alternate Director and represents Canada in the absence of the Canadian Director.

Role of Canadian Government Departments – Within the Canadian government, responsibility for oversight of the EBRD's activities resides with the International Finance and Economic Analysis Division of the Department of Finance. In consultation with the Department of Foreign Affairs and International Trade and CIDA, the Department of Finance regularly reviews the Bank's policy papers and proposed country strategies and provides advice to the Canadian Director.

Functions of the Canadian Director – In addition to participation in regular Board meetings, for much of 2000 the Canadian Director was also a member of the Financial and Operations Policies Committee, which reviews financial policies, including the Bank's borrowing policy, general policies relating to operations, and procedures and reporting requirements. Since September 2000 the Canadian Director has been a member of the Budget and Administrative Affairs Committee, which considers general budgetary policy,

proposals and procedures as well as personnel, administrative and organization matters, including administrative matters relating to Directors and their staff. The Canadian Director is also the Chairman of the Board Steering Group, which provides an important co-ordination and liaison function between the Board and senior Bank management.

Positions Taken in 2000 – To ensure the EBRD remains additional and contributes to the transition process, Canada continued to advocate increased Bank efforts on finding sound projects in countries in the early and intermediate stages of transition respecting the principles of multi-party democracy and making efforts at reform. In our view, only by focusing on quality will the Bank contribute to advancing the transition in these difficult markets. In the advanced transition countries Canada has underlined the need for Bank financing to be additional, as the Bank's Articles of Agreement state that it should not displace financing available from the private sector on reasonable terms. Therefore, we have urged the Bank to be innovative in the advanced transition countries by seeking out niche activities and developing new financial products that can push back the transition frontier in countries where private sector financial and capital markets are increasingly active in the EBRD's traditional sectors and product lines.

Canada's Voting Record

Canada and other shareholders typically raise concerns and questions about specific Bank operations before they get to the Board. As a result, decisions at the Board are generally taken by consensus without a formal vote. Nevertheless, the Canadian Director abstained or voted against the following policies and projects:

- He abstained on the Sovereign Pricing Policy because the criteria permitting derogations from the Bank's uniform pricing policy on sovereign loans were not, in Canada's view, sufficiently stringent with respect to additionality. Further, Canada always expressed a strong preference for maintaining uniform pricing.
- He abstained on a US$150-million loan to LUKOIL, one of the largest Russian oil companies, because of serious doubts about the Bank's additionality, given the profitability of the company in light of high oil prices, as well as concerns about reputation risks to the Bank stemming from the corporation's poor governance and lack of transparency.
- He voted against a EUR100-million loan to the state-owned Polish National Railways because of concerns about the loan's additionality.
- He voted against a US$52.5-million loan to Makstil for the production of steel plate in FYR Macedonia because of concerns that the project will not increase Makstil's knowledge of the international steel market and marketing capacity and thus will likely have little long-term transition impact.
- He abstained on a US$59.5-million loan and a US$5-million equity investment in VIZ Stahl, an electrical steel producer in Russia, because of lingering concerns about the project's potential transition impact.

Canada is a strong proponent of the Bank working in partnership with other international financial institutions to address the complex issue of institutional reform in the transition economies, as well as the need to improve social conditions in the countries of operation. The Canadian Director has also frequently spoken to the Board on the importance of the Bank's charter requirement that member countries be committed to market reform and multi-party democracy.

Canada has been a strong proponent of greater EBRD transparency and shareholder accountability, believing that the Bank should be a model of behaviour for the region. Therefore, Canada pushed hard for the EBRD to increase the transparency of its operations during the review of its public disclosure of information policy. Canada also strongly supported recent measures to strengthen internal governance at the Bank to ensure that all staff function at the highest standards of business integrity as well as efforts to strengthen the budget process. In particular, this included the development of a corporate scorecard, which Canada was instrumental in developing, and against which Bank staff performance will be measured.

In addition, Canada has been at the forefront in recognizing the role that the EBRD has to play in poverty reduction in the region while respecting the project-centred private sector focus of its mandate. The Canadian Director has played a leadership role in this area by encouraging greater emphasis on poverty reduction in the Bank's Country Strategies and better integration of EBRD work into the World Bank's Comprehensive Development Framework, a development strategy "owned" by the country and supported by partnerships among governments, donors, civil society, the private sector and development institutions. Combined, these efforts to improve transparency and accountability, internal governance and the institution's focus on poverty reduction support the call by G-7 finance ministers in June 2000 to strengthen the multilateral development banks.

Canadian Commercial Interests

The EBRD offers a wide variety of opportunities for Canadian businesses. One of the tasks of the Canadian office is to make Canadian business people aware of investment opportunities, explain how the Bank's contracting works and ensure that all contracts are awarded in accordance with the Bank's procurement policies and rules.

To achieve these objectives, the Canadian office provides market information and intelligence to Canadian firms, advises Canadian project sponsors on EBRD financing options, develops commercial co-financing opportunities with the Export Development Corporation and Canadian financial institutions, identifies and sources EBRD procurement opportunities with the Department of Foreign Affairs and International Trade and Industry Canada, and promotes Canadian technical co-operation activities and official co-financing between the EBRD and CIDA.

In 2000 EBRD participation in three Canadian-sponsored transactions was approved by the Bank's Board of Directors, representing EBRD financial commitments of 76.9 million euro. (The aggregate size of the three projects is 311.7 million euro.) A description of each of the Canadian-sponsored projects is given in Annex 2. Also in 2000 Canadian consultants were awarded four EBRD technical co-operation assignments totalling 533,382 euro. These assignments were in the following countries and sectors: Ukraine telecommunications regulatory development; Russia Far-East air navigation modernization; Romania municipal environmental strengthening; and Russia alluvial gold mining sector development. Looking forward, a key challenge for the Canadian Director's Office will be to broaden the base of high-quality Canadian project sponsors with whom the Bank invests, as well as to augment Canadian procurement awarded through competitive tender procedures in the EBRD's public sector operations.

Canadians are also well represented on EBRD staff. At the end of 2000 Canadians accounted for 4.4 per cent of the Bank's professional positions, above Canada's 3.4-per-cent share of the institution's capital. It is noteworthy that a Canadian heads the Baltic Team and another Canadian has been appointed as the new Director of Communications.

Promoting Canada's Interests

Members of the Canadian office made five visits to Canada in 2000 to meet with business people, conduct seminars, speak at conferences and consult with government officials. This included the Canadian Director speaking at the World Petroleum Congress in Calgary to promote the EBRD to the Canadian oil and gas industry; promoting the Bank to the Canadian financial and business community in Montréal; and speaking to the International Finance Club of Montréal about the EBRD and its region of operation. In addition, the Assistant to the Director promoted the EBRD to the Canadian environmental industry at the Vancouver Globe 2000 Conference in March and met with a large number of Canadian firms in Montréal and Toronto to inform them about the EBRD. The Canadian office has also met with at least 160 Canadians including provincial government representatives, consultants, academics, and representatives of law firms and banks.

Canada's commercial interests in the region were also promoted by:

- the Canadian Director meeting with the Canadian business community at the opening of the office of the Caisse de dépôt et placement du Québec in Paris;
- participation of the Canadian Director in the Canada-Russia Intergovernmental Economic Mission and the Central Europe Canadian Trade Mission in Hungary; and
- promotion by the Canadian Director's Assistant of the Canadian office and the EBRD as instruments for advancing Canadian commercial interests, particularly in the municipal environmental infrastructure sector, to a Quebec trade mission in Romania.

In addition, the Canadian Director and Assistant briefed Canadian parliamentarians visiting the caucuses in Azerbaijan and Kazakhstan respectively.

Challenges Ahead

Most of the countries of the region have made progress in economic and political transition since the early 1990s. Throughout this process the EBRD has, both directly and through the demonstration effects of its projects, helped to advance the transition process. The Bank has been important in catalyzing private sector investment in the region and has been a strong force in promoting entrepreneurship, particularly through its support for SMEs.

The last 10 years of transition have provided clear lessons for the future. Countries that have achieved the more rapid and comprehensive reforms – particularly in liberalizing markets and trade, hardening budget constraints and fostering the new private sector by removing obstacles to the entry and exit of enterprises – have laid solid foundations for sustaining progress in reform. In these economies market-supporting institutions have tended to develop. These institutional frameworks – predictable fiscal and regulatory environments, secure property rights, an impartial judiciary and sound financial supervision and regulation – combined with appropriate macroeconomic policies, are laying the foundations for sustained rapid growth and providing increased access to international capital markets.

In contrast, in some other countries in the Bank's region of operation, particularly those further east, progress in putting in place the institutions that underpin a market economy has been limited, and the process of liberalization and privatization is far from complete. As a result, economic growth remains vulnerable to external and internal shocks. In addition, the significant increase in poverty and inequality since the start of transition has eroded support for necessary reforms in many countries. Overcoming resistance to reform will be a challenge; it will require creating new employment opportunities and social fallback options for those displaced by structural change and breaking the hold of powerful vested interests over the reform process.

Good governance will continue to play a critical role in the future success of the region. Good corporate governance is one aspect of this role. However, the state also has a strong role to play in supporting an enabling investment climate by promoting sound institutions, administering tax collection and improving legal and regulatory frameworks. It must ensure that appropriate legislation is not only developed, but is also properly implemented and enforced.

In assisting its member countries over the next decade of transition, the EBRD will face significant challenges in growing and managing its portfolio. In the advanced transition countries, which are increasingly able to obtain private sector financing, the Bank will have to develop new products and activities to remain additional. In the early and intermediate transition economies and Russia, the challenge will be finding quality projects in a high-risk environment characterized by a lack of market-supporting institutions. Over the coming decade the Bank will have to work in close partnership with other international financial institutions to address these complex investment climate issues. Expanded co-operation with international financial institutions will be necessary to develop high transition impact projects with specific social benefits and poverty alleviation features that may strengthen the willingness of governments in the region to move forward with politically difficult but essential reforms, particularly the restructuring or closure of large enterprises.

A clear lesson from the past 10 years is that transition in the region is a complex and difficult process that will take longer than many initially expected. The primary responsibility for shaping a response to the challenges of transition lies with the countries themselves. The international financial institutions, particularly the EBRD, have an important supporting role to play. Canada will continue to strongly support these efforts.

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For More Information on the EBRD

The Bank releases considerable information on its various activities. Bank publications include information guides (e.g., *Financing With the EBRD*), special reports (e.g., the *Annual Report, Transition Report*), country strategies and assorted fact sheets.

Information can also be obtained on the Bank's Web site:

http://www.ebrd.com/

Requests for information can be addressed to:

Publications Desk
European Bank for Reconstruction and Development
One Exchange Square
London, EC2A 2JN
United Kingdom
(Fax: 44-20-7338-7544)

ANNEX 1

THE BANK'S FINANCIAL ACTIVITIES

The Bank's financial activities are divided into ordinary and special operations, depending on the source of funds. Ordinary operations are financed from the ordinary capital resources of the Bank, which comprise subscribed capital, market borrowings and income from loans and investments. Special operations are those financed by "Special Funds" for specially designated purposes that are typically outside the Bank's regular activities. Unlike other regional development banks, however, the EBRD does not operate a concessional or "soft" loan window.

Ordinary Capital Resources

At the end of 2000 the total authorized capital of the Bank was 20 billion euro (C$28 billion). Canada has subscribed to 3.4 per cent – or 680 million euro (C$958 million) – of the Bank's authorized capital. Canadian contributions to the Bank's capital are made in US dollars (at a pre-determined euro/US$ exchange rate).

In 2000 Canada made its third purchase of shares under the first capital increase (which came into effect April 3, 1997, and doubled the initial 10-billion euro capital base). Under the first capital increase, 77.5 per cent of our share is "callable," meaning that the Bank can request these resources in the unlikely event that it requires them to meet its financial obligations to bondholders; the balance, or 22.5 per cent, is "paid-in." Payments will be made in eight equal annual instalments of US$12,145,331.25 (40 per cent in cash and 60 per cent in non-interest-bearing demand notes encashed over five years). Under the initial capital, 30 per cent was paid-in over five years (split evenly between cash and notes encashed over a three-year period) and 70 per cent callable. Canada completed payments for the initial capital in April 1997. The table below details Canadian payments to the Bank in US dollars.

Canada's contributions to the Bank's capital are non-budgetary expenditures because our shares in the Bank are considered an asset. Nonetheless, Canada's contributions to the Bank do increase the Government's borrowing requirements.

Canadian Payments to the EBRD

Year	Notes	Cash	Encashment of notes	Total cash outlay
		(in US dollars)		
1991	11,903,502	11,903,502	11,903,502	23,807,004
1992	11,903,502	11,903,502	3,967,834	15,871,336
1993	11,903,502	11,903,502	7,935,668	19,839,170
1994	11,903,502	11,903,502	11,903,502	23,807,004
1995	11,903,502	11,903,502	11,903,502	23,807,004
1996	–	–	7,935,668	7,935,668
1997	–	–	3,967,334	3,967,334
1998	7,287,198	4,858,132	1,457,439	6,315,572
1999	7,287,198	4,858,132	2,914,878	7,773,010
2000	7,287,198	4,858,132	4,372,317	9,230,449
Total	81,379,104	74,091,906	68,261,644	142,353,551

Market Borrowings

At the end of 2000 cumulative borrowings by the Bank totalled 14.1 billion euro (C$19.9 billion) with an average maturity of 9.5 years at an average cost of funds of LIBOR (London Inter-Bank Offered Rate) minus 31 basis points. Funds have been swapped into floating-rate instruments, primarily in US dollars, euro and Deutsche Marks.

Standard & Poor's has assigned the Bank an AAA long-term and A1+ short-term credit rating. Moody's Investors Service has similarly rated the EBRD long-term bonds AAA.

Special Operations

The EBRD administers a number of bilateral and multilateral concessional funds. Canada has contributed to the following special funds:

The Canada Technical Co-operation Fund – The main purpose of this fund is to provide financing to hire Canadian consultants for EBRD projects. Canada has contributed C$7.66 million since the fund was established in 1992.

Chernobyl Shelter Fund – The main purpose of this fund is to secure the sarcophagus around the destroyed Unit IV nuclear reactor in Ukraine. The total estimated cost of this eight-year project is US$768 million, of which US$391 million has been pledged so far. Canada has pledged a contribution of US$20 million to be paid over six years starting in 1998.

Nuclear Safety Account (NSA) – This facility was established in 1993 to help finance the closure of the Chernobyl nuclear power plant and to improve safety conditions at nuclear power plants in countries of operation until the plants can be closed. The NSA complements other bilateral and multilateral nuclear safety

technical assistance and functions in parallel with multilateral efforts to achieve broader energy sector reform in the region. Canada has contributed C$19.5 million to the total fund of 289 million euro (C$407.3 million).

Russia Small Business Fund (RSBF) – The purpose of this fund is to establish a facility for small business finance and micro lending in various regions of Russia. Canada has contributed US$8.1 million towards the US$300-million fund, including a new contribution of US$2 million in 1998 for investments in northern Russia in response to the success of the fund. The RSBF was established in 1993 as a pilot project and became permanent in 1995.

Trust Fund for South Eastern Europe – At the end of 2000 CIDA approved a C$8-million contribution agreement with the EBRD for technical co-operation and co-financing activities in Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FYR Macedonia, Romania and the Federal Republic of Yugoslavia (Kosovo, Montenegro and Serbia) in support of the EBRD's South Eastern Europe Action Plan. C$6 million will be available to the EBRD for technical co-operation and co-financing tied to Canadian consultants and suppliers, with the remainder available to the EBRD for untied co-financing of critical investment projects under the Bank's Balkan Region Special Fund.

TurnAround Management Programme – The TurnAround Management Programme was established in 1992-93 to match up senior industrial advisors from market-driven economies with chief executives of selected firms in the region. The objective is to provide industrial management know-how and develop business skills so that these companies can become competitive and profitable. In 1999 Canada contributed C$550,000 to this program to be used to hire Canadian advisors.

Ukraine MicroFinance Bank – In 2000 CIDA entered into a contribution agreement with the EBRD to provide C$1.25 million over the next two years for the provision of technical assistance related to the development of the Ukraine MicroFinance Bank (MFB). The MFB will develop a branch network throughout Ukraine, with special attention being paid to Slavutych, the community where many employees of the Chernobyl nuclear power plant reside. As a greenfield operation specializing in financial services for the micro and small enterprise sector, the MFB will also serve as a demonstration bank for the Ukrainian commercial banking sector to show the commercial viability of micro and small enterprise lending.

Technical assistance in support of the Ukraine Micro, Small and Medium-Sized Enterprises Line of Credit II – Between 1999 and 2003 CIDA will provide C$3 million for technical assistance services by qualified Canadian organizations to Ukrainian commercial banks receiving loans under the EBRD's Ukraine Micro, Small and Medium-Sized Enterprises Line of Credit II for on-lending to micro, small and medium-sized enterprises. The technical assistance will include risk- and loan-evaluation training.

Annex 2

EBRD – Canadian-Sponsored Project Activity in 2000

Date of signing	Canadian company	Project country	Project name	Type of financing	Sector	EBRD commitment (millions of euro)	Total project cost (millions of euro)
June 2000	CADIM	Regional (Focus on Poland, Czech Republic and Hungary)	Central Europe Property Partners Fund	Equity	Property development	44.4	144.4
November 2000	Telesystem International Wireless Corporation	Czech Republic	Cesky Mobil	Equity	Tele-communications	27.8	144.4
December 2000	TrizecHahn	Regional (focus on Hungary)	Trigranit II	Equity	Property development	4.7	22.9
Total (euro)						76.9	311.7

Annex 3

Doing Business With the EBRD

General inquiries about working with the EBRD should be directed to the Office of the Director for Canada or to the Bank's **Communications Department** in London (tel: 44-20-7338-6096; fax: 44-20-7448-6690).

Canadian Project Sponsors: Canadian companies interested in potentially sponsoring a project with the EBRD are requested to direct initial inquiries either to Project Inquiries in London (tel: 44-20-7338-6282 or 44-20-7338-6252; fax: 44-20-7338-6102) or to the Bank's resident office in the country of operation. Summaries of EBRD private sector operations can be obtained on the Bank's Web site: http://www.ebrd.com/.

Canadian Suppliers of Goods and Works: The EBRD makes available information on all stages of public sector project development, from the point a project has been identified by the Bank through to its approval. Procurement opportunities and co-financing notices, as well as contract awards information, can be accessed on the Bank's Web site free of charge (see address above).

Canadian Consultants: The EBRD's Web site contains technical co-operation notifications and invitations for expressions of interest for consultancy services pertaining to both public and private sector projects. The EBRD also makes use of the World Bank's electronic Data on Consultants (DACON) registration system. Although it is not required for consultants to register with DACON to be eligible for EBRD assignments, it is nonetheless advisable as a useful marketing tool. Requests for DACON registration packages should be sent directly to:

DACON Information Centre
World Bank
1818 H Street
Washington, DC 20433 USA

Individual Canadians: The EBRD maintains a recruitment section on its Web site which provides information on specific employment competitions at the Bank as they become available. In general, applications for employment for both permanent positions and summer jobs should be sent to:

Franco Furno, Director of Personnel
Personnel Department
European Bank for Reconstruction and Development
One Exchange Square
London, EC2A 2JN
United Kingdom

Annex 4

EBRD Membership – As at December 31, 2000

	Share of the Bank's capital (%)
European Members	
Austria	2.28
Belgium	2.28
Cyprus	0.10
Denmark	1.20
Finland	1.25
France	8.52
Germany	8.52
Greece	0.65
Iceland	0.10
Ireland	0.30
Israel	0.65
Italy	8.52
Liechtenstein	0.02
Luxembourg	0.20
Malta	0.01
Netherlands	2.48
Norway	1.25
Portugal	0.42
Spain	3.40
Sweden	2.28
Switzerland	2.28
Turkey	1.15
United Kingdom	8.52
European Union	3.00
European Investment Bank	3.00
Non-European Members	
Australia	0.50
Canada	**3.40**
Egypt	0.10
Japan	8.52
Korea, Republic of	1.00
Mexico	0.15
Mongolia	0.01
Morocco	0.05
New Zealand	0.05
United States	10.00

	Share of the Bank's capital (%)
Countries of Operation	
Albania	0.10
Armenia	0.05
Azerbaijan	0.10
Belarus	0.20
Bosnia and Herzegovina	0.17
Bulgaria	0.79
Croatia	0.36
Czech Republic	0.85
Estonia	0.10
FYR Macedonia	0.07
Georgia	0.10
Hungary	0.79
Kazakhstan	0.23
Kyrgyzstan	0.10
Latvia	0.10
Lithuania	0.10
Moldova	0.10
Poland	1.28
Romania	0.48
Russia	4.00
Slovak Republic	0.43
Slovenia	0.21
Tajikistan	0.10
Turkmenistan	0.01
Ukraine	0.80
Uzbekistan	0.21

Report on Operations Under the European Bank for Reconstruction and Development Agreement Act

2001

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2001

Prepared by:
International Trade and Finance Branch
April 2002

Department of Finance Canada | Ministère des Finances Canada

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Introduction

The European Bank for Reconstruction and Development (referred to in this document as the EBRD or the Bank) was established in 1991. Its aims are to foster the transition towards open, market-oriented economies in Central and Eastern Europe, as well as in the successor states of the former Soviet Union, and to promote private and entrepreneurial initiative in those countries that are committed to the fundamental principles of multi-party democracy, pluralism and a market economy (see Annex 4 for a list of the EBRD's 27 countries of operation).

The EBRD differs from other regional development banks in four ways. First, its overriding focus is on the private sector and support for the transition from central planning to stable market economies. Its charter stipulates that not less than 60 per cent of its financing commitments should be directed either to private sector enterprises or to state-owned enterprises implementing a program to achieve private ownership and control. Second, the EBRD's mandate gives it a particular focus on the promotion of democratic institutions and human rights in its countries of operation. Third, the EBRD is explicitly committed under its Articles of Agreement to ensuring the environmental sustainability of all its projects. Fourth, the EBRD does not provide concessional financing.

The Bank seeks to help its 27 countries of operation to implement structural and sectoral economic reforms, taking into account the particular needs of countries at different stages in the transition process. In particular, its private sector activities focus mainly on enterprise restructuring, including the strengthening of financial institutions, and the development of infrastructure needed to support the private sector. The EBRD has 62 members: 60 countries, the European Union (EU) and the European Investment Bank (see Annex 4 for a list of members).

Canada is the eighth largest shareholder (tied with Spain), following the other Group of Seven (G-7) countries and Russia. Our formal participation is authorized under the European Bank for Reconstruction and Development Agreement Act, which was promulgated in February 1991. Article 7 of the Act states that:

> The Minister [of Finance] shall cause to be laid before each House of Parliament by March 31 of each year or, if that House is not then sitting, on any of the thirty days next thereafter that it is sitting, a report of operations for the previous calendar year, containing a general summary of all actions taken under the authority of this Act, including their sustainable development aspects within the meaning of Article 2 of the Agreement, and their human rights aspects.

This report responds to this requirement and reviews the activities and operations of the Bank for the year 2001.

Benefits of Membership

As a major trading nation, Canada has a stake in global peace and stability. The successful integration of Central and Eastern Europe and the former Soviet Union into the world economy and global institutions helps to promote peace and stability. By fostering continued economic reform in the region, the EBRD is contributing to its integration into the world economy and to its stability.

EBRD membership provides a number of specific benefits:

- The Minister of Finance is a Governor of the Bank and elects a Director to its 23-member Board of Directors. This representation allows Canada to have high-level influence on decisions taken by the EBRD on investments in the region and on policies to move forward regional development.
- The EBRD provides trade opportunities for the Canadian private sector, allows a diversification of international markets for Canadian business, and supports investments by Canadian business in the region.

Role and Mandate of the EBRD

The EBRD

- fosters the transition of former centrally planned economies of Central and Eastern Europe and the successor states of the former Soviet Union towards market-oriented economies;
- promotes private entrepreneurial initiative by targeting at least 60 per cent of its resources to private sector projects, with the balance in support of commercially viable state sector projects that promote private sector development;
- operates only in countries committed to applying the principles of multi-party democracy, pluralism and market economics;
- promotes environmentally sound and sustainable development; and
- operates on a self-financing basis.

The EBRD's operations to advance the transition to a market economy are guided by three principles: maximizing transition impact, additionality and sound banking. Financing is provided for projects that expand and improve markets, help to build the institutions necessary for underpinning a market economy, and demonstrate and promote market-oriented skills and sound business practices. EBRD financing must also be additional to other sources of financing and not displace them, further ensuring that the Bank contributes to the transition process. Finally, Bank projects must be sound from a banking perspective, thus demonstrating to private investors that the region offers attractive returns. Adherence to sound banking principles also helps to ensure the financial viability of the EBRD and hence its attractiveness as a co-investment partner for the private sector.

In promoting economic transition in its countries of operation, the Bank acts as a catalyst for increased flows of financing to the private sector. The capital requirements of these countries cannot be fully met by official multilateral and bilateral sources of financing, and many foreign private investors remain hesitant to invest in the region, particularly the eastern part. By providing an umbrella under which wider funding for private sector investment can be assembled, the EBRD plays a catalytic role in mobilizing capital. In 2001, for every euro the EBRD invested, it mobilized an additional €2.7 from the private sector and multilateral and bilateral agencies.[1]

Indeed, the projects of the Bank serve a dual purpose. They are intended not only to directly support the transition from a command to a market economy in countries of operation, but also to create a demonstration effect to attract foreign and domestic investors. Like the World Bank Group's International Finance Corporation, the Bank is required to operate on a strictly commercial basis and to attract companies through financially viable projects, not through subsidies.

[1] On December 28, 2001, one euro purchased 1.4080 Canadian dollars.

Key Economic Developments in 2001

Real gross domestic product (GDP) grew by 4.3 per cent for the region as a whole in 2001, down from 5.5 per cent in 2000. The slowdown in economic growth reflected the overall weakening of the world economy, particularly in the EU and Russia. The Commonwealth of Independent States (CIS)[2] countries experienced the largest drop in economic growth, from 7.9 per cent in 2000 to 5.8 per cent in 2001, primarily due to the economic slowdown in Russia, which saw its growth rate drop from 8.3 per cent in 2000 to 5.2 per cent in 2001. In the transition countries of Central Europe and the Baltic States,[3] the overall rate of growth fell from 4.0 per cent in 2000 to 2.9 per cent in 2001. In Southeastern Europe[4] output increased 3.6 per cent in 2001, down slightly from 4.0 per cent in 2000.

Reform efforts in most countries were sustained in 2001, as measured by the EBRD's transition indicators (see table on page 9). Several countries in Southeastern Europe benefited from improvements in the political and economic climate and, as a result, were able to make significant progress in reforms, particularly Bosnia and Herzegovina and FR Yugoslavia. Most of the EU accession candidate countries continued to make steady progress. Russia and other CIS countries also made progress in their reform efforts, except for Turkmenistan, which regressed from the limited progress that had been made in previous years.

The following table ranks transition countries by their progress in moving to a market economy, based on a number of indicators.

[2] Includes Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan.

[3] Includes the Czech Republic, Hungary, Poland, the Slovak Republic, Slovenia and the three Baltic States (Estonia, Latvia and Lithuania).

[4] Includes Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the Former Yugoslav Republic of Macedonia (FYR Macedonia), Romania, and the Federal Republic of Yugoslavia (FR Yugoslavia), which became a member of the Bank in early 2001. Kosovo is a province of FR Yugoslavia.

Progress in Transition in EBRD Countries of Operation

Countries	Population (millions, mid-2001)	Private sector share of GDP in %, mid-2001 (EBRD estimate)	Enterprises: Large-scale privatization	Enterprises: Small-scale privatization	Enterprises: Governance and enterprise restructuring	Market and trade: Price liberal-ization	Market and trade: Trade and foreign exchange system	Market and trade: Compe-tition policy	Financial institutions: Banking reform and interest rate liberalization	Financial institutions: Securities markets and non-bank financial institutions
Albania	3.4	75	2+	4	2	3	4+	2-	2+	2-
Armenia	3.8	60	3	4-	2	3	4	2	2+	2
Azerbaijan	8.1	60	2	3+	2	3	3+	2	2+	2-
Belarus	10.0	20	1	2	1	2	2	2	1	2
Bosnia and Herzegovina	4.3	40	2+	3-	2-	3	3	1	2+	1
Bulgaria	8.1	70	4-	4-	2+	3	4+	2+	3	2
Croatia	4.6	60	3	4+	3-	3	4+	2+	3+	2+
Czech Republic	10.3	80	4	4+	3+	3	4+	3	4-	3
Estonia	1.4	75	4	4+	3+	3	4+	3-	4-	3
FR Yugoslavia	8.6	40	1	3	1	3	3	1	1	1
FYR Macedonia	2.0	60	3	4	2+	3	4	2	3	2-
Georgia	5.4	60	3+	4	2	3+	4+	2	2+	2-
Hungary	10.0	80	4	4+	3+	3+	4+	3	4	4-
Kazakhstan	14.9	60	3	4	2	3	3+	2	3-	2+
Kyrgyzstan	4.7	60	3	4	2	3	4	2	2+	2
Latvia	2.4	65	3	4+	3-	3	4+	2+	3+	2+
Lithuania	3.7	70	3+	4+	3-	3	4+	3	3	3
Moldova	4.3	50	3	3+	2	3+	4+	2	2+	2
Poland	38.7	75	3+	4+	3+	3+	4+	3	3+	4-
Romania	22.3	65	3+	4-	2	3+	4	2+	3-	2
Russia	145.4	70	3+	4	2+	3	3-	2+	2-	2-
Slovak Republic	5.4	80	4	4+	3	3	4+	3	3+	2+
Slovenia	2.0	65	3	4+	3-	3+	4+	3-	3+	3-
Tajikistan	6.2	45	2+	4-	2-	3	3+	2-	1	1
Turkmenistan	5.4	25	1	2	1	2	1	1	1	1
Ukraine	49.3	60	3	3+	2	3	3	2+	2	2
Uzbekistan	25.0	45	3-	3	2-	2	2-	2	2-	2

Note: The classification of transition indicators uses a scale from 1 to 4, where 1 implies little or no progress with reform and 4 implies a market economy. A rating of 4+ indicates the country has achieved standards and performance typical of advanced industrial economies.

Source: EBRD, 2001 *Transition Report*.

Russia

Russia's macroeconomic fundamentals remain strong, and it is making progress on key structural reforms. Real GDP growth reached 5.2 per cent in 2001, while the federal budget posted a surplus for the second year in a row. Economic growth was supported by robust growth in business fixed investment and consumer spending. The current account surplus is large at 11.2 per cent of GDP, which allowed the central bank to boost its international reserves by US$8.6 billion during the year to US$36.5 billion.

The key risks to Russia's economic outlook in 2002 are its vulnerability to changes in international energy prices and the risk of rising inflation. A deep, sustained fall in energy prices would adversely affect its fiscal and external accounts. While inflation is on a downward trend, at 18.6 per cent (year-over-year) in December, it remains well above that of advanced transition countries. The central bank's expansionary monetary policy framework has led to continued growth in the money supply, which could put upward pressure on inflation.

Russia appears very able to address the large "hump" in its external obligations in 2003 due in part to its proactive liability management, which includes substantial buybacks of sovereign bonds and early repayments of International Monetary Fund debt. Over the last year Russia has implemented structural reforms related to fiscal matters, banking and corporate governance. A number of other important reforms are starting to be addressed, including pension and judicial reforms. Russia has also expressed a desire to become a member of the World Trade Organization (WTO) before the next trade ministerial conference in 2003, but it must first adjust foreign trade legislation to meet WTO standards.

Despite important progress on structural reform, serious weaknesses remain in the overall environment for business, competition and investment in Russia. The low number of small private businesses, persistent capital flight and rather low investment outside of the oil and gas sectors underscore this reality. Although they have showed signs of improvement since the 1998 financial crisis, Russian commercial banks generally remain weak, poorly capitalized, and without reliable sources of profit.

Other CIS Countries

The other CIS countries also experienced slower economic growth in 2001. Lower oil production and falling oil prices contributed to this weakening economic performance for the oil-producing countries, such as Kazakhstan and Azerbaijan. Ukraine was the exception, with real GDP growth reaching about 9 per cent due to strong exports (especially to Russia), continued external competitiveness resulting from the substantial depreciation of its currency in 1998-99, and increased capacity utilization.

Inflation in the region continued to fall, except in Belarus, Tajikistan and Uzbekistan, where delays in implementing reforms led to continued inflationary pressures. Inflation in Ukraine fell to about 12 per cent from 26 per cent in 2000, largely as a result of a good grain harvest, which led to lower food prices.

Despite the implementation of fiscal reforms in many of the CIS countries, the public finances of several countries, particularly Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan, remain weak, primarily due to the interest burden resulting from large and unsustainable public debt levels.

The CIS countries continue to face significant challenges in terms of their central-planning legacy, the extent of structural distortions and the limited capacity of state institutions. In addition, they continue to lag considerably behind Central Europe and the Baltic States in implementing structural reforms (see table on page 9). Nonetheless, difficult structural reforms have begun in a number of countries, notably Armenia, Azerbaijan, Georgia and Ukraine. Turkmenistan was the one country in the region that fell back, regressing from the little progress it had made to date in implementing reforms. It remains to be seen, however, whether further reforms will be undertaken in countries such as Belarus, Uzbekistan and Turkmenistan, where there is little political commitment to market-oriented reforms.

Central Europe and the Baltic States

Real GDP growth in Central Europe and the Baltic States slowed in the latter half of 2001, as exports to the EU fell as a result of the economic slowdown in the EU. However, in some countries, such as the Czech Republic and Hungary, the drop in exports was partially offset by strong domestic demand. Current account deficits were high, at over 6 per cent of GDP, in the majority of countries in Central Europe, leading to substantial external financing requirements. Most of these countries, however, have been able to attract large inflows of foreign direct investment and other external funding, which have offset the current account deficits.

The improvement in economic performance in many countries of Central Europe and the Baltic States over the last few years has been fostered by significant gains in competitiveness due to successful enterprise restructuring and by the creation of market-supporting institutions (fiscal, legal, financial and social). Poland and Hungary, in particular, have advanced significantly in the transition process and appear well poised for long-term sustained economic growth. There are downside risks, however, for a number of countries, with the ability of monetary and fiscal policies to respond to an economic slowdown limited by inflationary pressures (in Hungary, in particular) and rising government deficits (for example, in Hungary and Poland).

Accession to the European Union

Expected accession to the EU has been an important factor underlying economic and political reform efforts in Central and Eastern Europe. Accession negotiations are currently underway with 12 countries: Bulgaria, Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, the Slovak Republic and Slovenia. At least 3 countries (the Czech Republic, Hungary and Slovenia) are expected to have completed their negotiations within the next two years.

The EBRD, European Commission and World Bank have signed a memorandum of understanding setting out the basic principles for collaboration in supporting projects that will assist all accession countries in meeting the requirements of the EU. In particular, the accession countries face specific requirements for investment in infrastructure to meet the requirements of the EU's *acquis communautaire*, or inventory of EU laws and standards. The EBRD actively supports projects where its mandate and EU accession requirements overlap.

The EU has also offered the prospect of eventual EU membership for the countries of Southeastern Europe through the Stabilisation and Association Process. Under this process, the EU has started to negotiate Stabilisation and Association Agreements with democratic, reform-minded countries in the region. The Agreements offer the prospect of better trade access, increased assistance for education and institution building, co-operation in the areas of justice and home affairs, formal political relations with the EU and, one day, membership in the EU. It is hoped that the prospect of EU membership will spur reform efforts in Southeastern Europe as it has done in Central Europe and the Baltic States. Thus far the EU has entered into or completed negotiations to establish agreements with FYR Macedonia, Albania, Croatia, Bosnia and Herzegovina, and FR Yugoslavia.

Southeastern Europe

After three years of recession real GDP growth increased in Southeastern Europe in 2000. This growth continued in 2001, primarily due to strong domestic and export demand in the first half of the year. Export demand from the EU fell in the latter part of the year and will likely have a negative impact on growth in 2002. While inflation in the region has been falling, it remains high, especially in FR Yugoslavia and Romania. Current account deficits also remain high. Unlike in Central Europe and the Baltic States, these deficits have been financed primarily by official sources of financing rather than foreign direct investment.

Domestic political changes in several of the countries of Southeastern Europe led to accelerated reform efforts. In both FR Yugoslavia and Albania, improvements in political stability helped to attract new investment and donor financing. FYR Macedonia, on the other hand, was the only country in the region to experience negative growth in 2001, due to continued ethnic conflict and slow progress in implementing reforms.

Canada's Co-operation With the EBRD in Southeastern Europe

In response to the Kosovo crisis in 1999, the EBRD developed the South Eastern Europe Action Plan (SEEAP), which seeks to promote investment and to assist in the economic recovery of the region. Eligible countries are Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FR Yugoslavia, FYR Macedonia and Romania.

Under the SEEAP, EBRD investments focus on developing commercial approaches to infrastructure (such as telecommunications, airports, and municipal and environmental infrastructure), small, medium, and micro enterprises, and the financial sector. This focus reflects the transition challenges facing the region: crumbling infrastructure, a weak industrial asset base, mostly small, fragile banks and pervasive problems of economic governance.

In support of the SEEAP, the Canadian International Development Agency (CIDA) established a C$6-million Cooperation Fund for Southeastern Europe, which is tied to the use of Canadian companies and consultants. In addition, CIDA made an untied contribution of C$2 million to the Balkan Region Special Fund to support priority investment projects in the region.

Canada's assistance has contributed to the efforts of both the EBRD and the international community in supporting the transition process and promoting stability in the region. CIDA's funding has been used for technical assistance and co-financing related to project preparation and implementation, advisory services and capacity building. During 2001 six projects were supported under both funds for a total of C$6.7 million. Three of these projects targeted the transport sector, with the other three focused on municipal infrastructure and capacity building.

2001 *Transition Report*

The *Transition Report* is an annual publication of the EBRD that charts the progress of transition from a centrally planned to a market economy in each of the Bank's 27 countries of operation. Each year the report has a special theme. In 2001 it examined the role of energy in the transition process.

The report notes that the transition economies, like advanced economies, are highly dependent on fossil fuels as sources of energy. At the same time, Russia, Azerbaijan, Kazakhstan, Turkmenistan and Uzbekistan have substantial reserves of oil and gas that could be used to supply the region's demand for energy. Russia is the only country in the region with a well-developed oil and gas sector, however. While the other countries have the potential to become important international suppliers of oil and gas, to be able to fully develop their oil and gas reserves, they need significant investment, much of which will have to come from external sources.

Foreign investment will only be attracted to the region, however, if the countries can offer a stable investment climate and competitive tax arrangements. This requires improved corporate governance and financial transparency on the part of domestic producers, improved state governance, and a shift in the role of the state in the energy sector from that of owner to that of regulator, including over environmental issues. Governments also need to foster competitive market access and improve their management of resource rents in order to ensure longer-term sustainable development of this sector and of their overall economies. In general, however, the energy-producing countries have tended to make less progress on market liberalization and reform than other transition countries, as income from the oil and gas sectors has reduced the fiscal necessity to implement reforms.

The transition economies are also inefficient in their use of energy compared to more advanced countries. While energy efficiency has improved in Central Europe and the Baltic States and in Southeastern Europe, all transition countries lag significantly behind Organisation for Economic Co-operation and Development countries in this area. Slow progress in energy sector reform and inappropriate energy tariff policies have been the main factors delaying improvements in energy efficiency. As a result, energy consumption per capita is higher than in Western European countries, pollution levels remain high, and more environmentally sustainable technologies have not yet been widely introduced.

The report concludes that energy tariff reform is key to improving energy efficiency but cautions that, in order to be politically and socially acceptable, targeted support for poor households to help them pay for increased energy prices will be needed.

Capital Resources Review

The Bank's Articles of Agreement mandate a review of the Bank's capital resources every five years. In 2001 the Board of Governors approved the second review of the EBRD's capital resources. The review focused on ensuring that the Bank's portfolio as a whole reflects the transition objectives and operational priorities of the Bank. In addition, emphasis was placed on balancing the Bank's portfolio across countries, products and risk categories. The review also placed emphasis on accelerating the pace of portfolio growth, both to increase the transition impact of the Bank's activities and to increase the rate of growth of its earnings so as to allow the Bank to cover, on a sustainable basis, its administrative costs and expected losses.

The review noted that between 1995 and 2000, the Bank's portfolio more than doubled, rising from €5.7 billion at the end of 1995 to €12.2 billion at the end of 2000, making the Bank a major investor in the region. It was able to do this despite the Russian financial crisis in 1998, which affected a number of the Bank's countries of operation.

The review noted that over the five years, the Bank's activities had shifted from advanced to early and intermediate transition countries, although activities in the advanced transition countries remain significant.[5] The sector composition of the portfolio has remained broadly stable over the five-year period, with the proportion of shares of the corporate, financial institution and infrastructure sectors remaining around 40:30:30. The private sector share of annual business volume increased from 73 to 78 per cent over the period.

The review confirmed that the doubling of the EBRD's capital to €20 billion following the 1996 capital resources review had been necessary, as by 1998 capital utilization exceeded the original €10 billion capital limit. The review also concluded that the capital increase in 1996 gave the Bank sufficient capital to support its projected medium-term portfolio expansion.

2001 Financial Results

The continued profitability of the EBRD in 2001 reflects high net interest income, significant recoveries from projects that had experienced difficulties, strong treasury results and continued budgetary discipline. The Bank has been able to continue to rebuild its reserves (shareholder capital set aside to cover unanticipated events) by releasing provisioning taken in the aftermath of the Russian financial crisis.

In addition, the level of disbursements grew substantially from 2000. Ultimately, an objective of the Bank is to generate sufficient income to cover its operating costs. In order to achieve this, the Bank's earning asset base must grow, which requires an increasing portfolio of investments.

The increasing access of the advanced transition countries to private capital and financial markets and the continued poor investment climate in many early and intermediate transition countries create a challenge for the Bank. The Bank needs to balance the requirement to apply sound banking principles with the need to provide transition assistance to countries where the investment climate is risky. The financial results for 2001 suggest that, so far, the Bank has managed to achieve this balance. The challenge over the coming year will be to maintain this balance in an environment of slower economic growth.

The EBRD's general administrative expenses in 2001 were within budget and comparable to those for 2000, reflecting continuing budgetary discipline, effective cost controls and a proactive cost-recovery program.

Even before the events of September 11, the slowdown in economic growth in the US and the EU was expected to have a negative impact on the economic growth of the transition countries. The increased uncertainty of world

[5] Advanced transition countries include Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic and Slovenia. Early and intermediate transition countries include the balance of the EBRD's countries of operation, excluding Russia: Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, FR Yugoslavia, FYR Macedonia, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Romania, Tajikistan, Turkmenistan, Ukraine and Uzbekistan. Russia is considered to be in a category of its own by the EBRD.

economic growth presents new challenges to the Bank in the next year as it looks to increase the size of its portfolio through sound investments. Nonetheless, the medium-term prospects for the region remain good. The EU accession process will continue to attract private investment to Central Europe and the Baltic States, while the restoration of some political stability and economic reform in FR Yugoslavia should improve the prospects for Southeastern Europe. In Russia progress in implementing economic reforms has improved its prospects, although the process is far from complete.

Financial Highlights

- Profits after provisions increased to €157.2 million (C$221 million), up from €152.8 million in 2000.[1]
- Provision charges totalled €137.6 million (C$194 million) in 2001, below the €174.3 million in 2000, due to successful asset recovery, particularly in Russia.
- Operating income was €501.5 million (C$705 million), down slightly from €519.2 million in 2000.
- Gross disbursements rose by 67 per cent to €2.4 billion (C$3.4 billion) in 2001 from €1.5 billion in 2000.
- Annual business volume in 2001 reached €3.7 billion for 102 operations, a 37-per-cent increase from 2000. Of this amount, 44 per cent went to advanced transition countries, 33 per cent to early and intermediate transition countries, and 23 per cent to Russia. The annual business volume in the early and intermediate transition countries increased by 14 per cent from 2000, to €1.2 billion from €1.1 billion. In Russia annual business volume increased by 42 per cent to €822 million from €579 million.
- The Bank mobilized €2.7 in additional financing for every euro that it invested in 2001, up significantly from €1.9 in 2000.
- The private sector share of annual business volume was 76 per cent, down slightly from 78 per cent in 2000.
- Administrative expenses, denominated in pounds sterling (the currency in which most of the Bank's expenses accrue), were just below budget at £138.5 million.
- Reserves[2] at the end of 2001 were €488.7 million (C$688 million).

[1] Provisions for losses are subtracted from operating income along with other expenses. For private sector projects, which make up the bulk of the EBRD portfolio, provisioning follows a risk-based approach. Management continually reviews the portfolio to ensure that the current value of loans and investments reflects management's best estimate of the recoverability of Bank assets.

[2] Reserves are Bank capital set aside to cover unexpected losses.

Institutional Developments

Private Sector Development

A key part of the EBRD's work with the private sector is its support of micro, small and medium-sized enterprises (SMEs), which are potentially important engines for job creation and growth, and therefore poverty reduction, in the region. Canada is a strong proponent of the private sector work of the Bank, recognizing that a strong private sector is key for the successful transition to a market economy. Canada views a strong SME sector as one means for developing a "constituency for reform" in the transition economies that can act as a counterweight to powerful vested interests that benefit from weak state governance.

The Bank's strategy for the SME sector is founded on three pillars: financing, improving the investment climate through policy dialogue, and developing business support networks for SMEs. The strategy explicitly recognizes that the poor investment climate, and not just limited access to financing, is a major impediment to the development of the sector. The strategy emphasizes the need to identify and promote the removal of the main obstacles to SME growth, as well as to encourage the development of strong business associations.

About 76 per cent of the EBRD's annual business volume in 2001 was in the private sector, down slightly from about 78 per cent in 2000. In 2001 the EBRD increased the number of credit lines for SMEs to financial intermediaries and expanded its various small business programs. New commitments for SME financing rose to nearly €700 million. In the EU accession countries, the EU/EBRD SME Finance Facility provided €223 million in SME financing to 17 banks, which made, on average, sub-loans of €24,000. The microlending programs disbursed over €650 million through more than 70,000 micro and small loans.

Activities in the Financial Sector

Financial Sector Policy – The EBRD's financial sector policy takes a country-specific approach to financial sector development, focusing on the need to promote confidence and competition in an independent financial system. The EBRD seeks to strengthen confidence in the sector primarily by helping to improve local institutions' governance and business practices. It also tries to improve financial supervision and regulation, although its activities here are constrained by its investor role in the sector and potential concerns about conflict of interest. Nonetheless, as a reputable foreign investor in the sector, the EBRD offers important insights on supervisory and regulatory requirements, which it shares with other international financial institutions operating in the region and with governments. To address competition and independence, EBRD investments attempt to increase the diversity of

institutions and services available (particularly to the private sector and SMEs), facilitate foreign direct investment and strengthen the commercial orientation of state-owned financial institutions, particularly in preparation for privatization.

In 2001 the EBRD committed financing to 33 financial sector operations, bringing total EBRD exposure to the financial sector region-wide to €5.9 billion. Financial sector operations represent about 30 per cent of the EBRD's portfolio.

Banking Sector Activities – In 2001 the EBRD signed new loans valued at €591 million to the banking sector and took €184 million in new equity positions in local banks. In most cases where the EBRD holds an equity stake in a local financial institution, it is represented on the supervisory board of the institution, where it promotes management accountability, good corporate governance, sound banking practices and appropriate environmental reviews and procedures. Participation in bank privatizations is a key factor behind equity investments in early and intermediate transition countries.

Non-Bank Financial Institutions – During 2001 the EBRD also stepped up its activities in the non-bank financial sector, especially in the EU accession countries, predominantly by taking minority equity stakes in insurance companies and asset management/mutual fund companies, and by expanding its support for leasing activities. A total of seven new transactions were signed in the non-bank financial sector during the year, with new commitments of €93 million. The EBRD is one of the largest financial investors in this sector, with investments in local asset management and mutual fund companies becoming increasingly important as voluntary pension sectors in the Bank's countries of operation develop. By the end of 2001 the Bank had investments in the non-bank financial sector in nearly all the countries in the region, where necessary institutional and regulatory regimes had been or were in the process of being introduced.

Environment

Support for the environment remained a key priority in 2001, reflecting the Bank's mandate to ensure sustainable long-term development in its countries of operation. The Bank fulfills its environmental mandate principally through its projects. In 2001 the Bank provided financing of over €240 million in support of environmental projects, mainly in the areas of municipal infrastructure (water and waste management) and energy efficiency. Other projects also had environmental components, such as reduction in emissions and recycling. In addition, to help address some of the environmental challenges of northern Europe, the EBRD launched the Northern Dimension Environmental Partnership, which focuses on projects aimed at cleaning up the environment in the region, including the Baltic States and northwest Russia.

The EBRD also contributes to international initiatives such as the "Environment for Europe" process, including the Environmental Action Plan for Central and Eastern Europe, the Danube River Basin Strategic Action Plan, and the

Helsinki Commission and the Global Environment Facility, for which it became an executing agency in 1999. Within the framework of its mandate, the EBRD supports relevant multilateral and regional agreements on the environment and sustainable development, including the Framework Convention on Climate Change and the measures agreed to in the Kyoto Protocol.

The EBRD applies environmental due diligence to all its investment and technical co-operation operations. Project sponsors are required by the Bank to undertake environmental impact assessments, analyses and audits that address potential environmental, health and safety, and socio-economic impacts of projects. Environmental impact assessments and analyses are conducted when potential impacts are significant. Environmental audits are performed when a project relates to an existing operation. In some cases both an audit and assessment/analysis are required. The EBRD also requires local financial intermediaries, through which it channels funds to micro, small and medium-sized enterprises, to adopt appropriate environmental policies and procedures. In 2001 the EBRD provided financing to 15 environmental projects worth more than €240 million and conducted 56 environmental analyses, 4 environmental impact assessments and 28 environmental audits on projects approved by the Board of Directors.

The EBRD has an Environmental Advisory Council (ENVAC), which provides advice to the Bank on issues related to the EBRD's environmental mandate. ENVAC is composed of environmental experts from both the public and private sector. In 2001 it discussed environmental and social issues associated with oil and gas projects, biodiversity issues and health and safety issues associated with the EBRD's operations.

The EBRD also has an environmental training program, financed primarily by the EU's Phare and Tacis programs. In 2001 environmental training was provided to 22 financial institutions in 14 countries to help them better understand their exposure to environmental risk and the business opportunities that exist in areas such as financing energy efficiency improvements.

The EBRD has also established Corporate Environmental Awards to promote high standards of environmental practice in the Bank's countries of operation. The awards provide recognition to companies that reduce environmental damage through innovative products, services or systems or through implementation of clean production techniques or recycling programs. In 2001 two companies received the award: Pliva, a pharmaceutical company in Croatia, and Polar Lights Company, an oil production company in Russia.

In 2001 the EBRD completed an independent evaluation of 39 of its projects that had strong environmental components and looked at other environmental aspects of the Bank. The evaluation concluded that the Bank has done well in its environmental performance and has been able to improve the overall environmental performance of its projects, especially in the municipal and

environmental infrastructure, natural resources, and industry and manufacturing sectors. It has made less progress in improving environmental performance in the energy and transport sectors.

The evaluation also concluded that the EBRD has been able to help companies comply with many of the relevant domestic and EU or World Bank environmental regulations and guidelines and to meet the objectives of the EBRD's Environmental Action Plans. Nonetheless, there is still room for improvement. The Bank could do more through technical co-operation, working with non-governmental organizations (NGOs), and providing more support to environmental and energy service companies.

Municipal and Environmental Infrastructure

EBRD investments in this sector focus on upgrading local facilities, such as municipal waste-water treatment plants, and on raising the service levels of municipal and local utility companies. Reducing costs and increasing the reliability of municipal services can stimulate the development of commercial and industrial enterprises. At the same time, greater access to clean water and sanitation services improves public health and increases public confidence in the transition process and ongoing reform efforts.

Over the last few years the EBRD has increasingly relied on municipal, as opposed to sovereign, guarantees in this sector, providing local governments with important new financial opportunities and responsibilities. The EBRD's operations policy for municipal and environmental infrastructure emphasizes private sector involvement, the development of appropriate regulatory structures and improvements in energy efficiency.

In 2001 the EBRD committed €188 million to nine municipal and environmental infrastructure projects.

Energy Sector Investments

Most of the EBRD's countries of operation suffer from severe economic and environmental problems caused by polluting energy systems and inefficient energy pricing. In 2000 the EBRD reviewed and updated its Energy Operations Policy, which sets out how the Bank intends to promote energy efficiency through its operations. One of the revised policy's key objectives is to improve environmental performance, including meeting climate change objectives and supporting renewable forms of energy. In addition, the 2001 *Transition Report* focused on the energy sector and its role in transition.

In 2001 the Bank committed €364 million to projects in the energy sector, bringing cumulative commitments in this sector to over €1.8 billion. The Bank commissioned a consultant to develop an efficient way of measuring greenhouse gas emissions as part of the Bank's environmental assessment of potential projects.

The EBRD and Nuclear Safety

Canada and other G-7 countries have been working closely with the EBRD to improve nuclear safety in countries of Central and Eastern Europe and in the former Soviet Union. To facilitate this work, Canada has contributed to the Nuclear Safety Account (NSA), which the EBRD administers on behalf of the G-7 countries and other contributors. The NSA is used primarily for making essential safety improvements to older-generation, Soviet-built reactors and to help Ukraine cope with the aftermath of Chernobyl. As of December 31, 2001, pledges to the NSA totalled €261 million (C$367.5 million). Canada has contributed C$19.5 million.

On behalf of the G-7, the Bank has agreed to administer the US$768-million Chernobyl Shelter Fund for securing the sarcophagus around the destroyed – by nuclear accident – Unit IV reactor in Ukraine. The G-7 nations, the EU and other countries have pledged US$716 million, of which Canada has pledged a contribution of US$33 million.

In 2000 three International Decommissioning Support Funds were created to assist with the decommissioning of potentially unsafe nuclear reactors in Lithuania (Ignalina Units 1 and 2), the Slovak Republic (Bohunice VI Units 1 and 2) and Bulgaria (Kozluduy Units 1–4). The €500 million in grant funds will assist these countries with the early phase of decommissioning as well as with restructuring, upgrading and modernizing the energy production, transmission and distribution sectors, and improving energy efficiency more generally.

In December 2000 the EBRD approved in principle a US$215-million loan to Ukraine's nuclear operator for the completion of and safety upgrades to the Khmelnitsky Unit 2 and Rovno Unit 4 (K2R4) nuclear power plants. Canada supported this project at the EBRD Board. It considered that this project would contribute to a substantial improvement in nuclear safety and to energy sector reform in Ukraine. In addition, EBRD financing would ensure that K2R4 would be completed to Western safety standards, as it was conditional on assurances that nuclear safety standards in Ukraine would be further improved and properly maintained.

EBRD financing was conditional on the permanent closure of the older Chernobyl 3 reactor, which occurred on December 15, 2000, as well as several other financing conditions. By November 2001 Ukraine had met all the required conditions and the loan was scheduled to go before the EBRD Board for final approval on November 29, 2001. On November 28 Ukraine unexpectedly indicated that it wanted a last-minute renegotiation of some of the loan conditions, specifically the level at which electricity prices were to be set and the total cost of the project. As a result, no decision was taken and any loan agreement now requires a full review of all terms and conditions. Detailed technical discussions are taking place between the EBRD and Ukraine to determine whether a new agreement can be negotiated.

Addressing Corruption and Poor Governance

The Bank's medium-term priorities include addressing issues of corruption and poor governance, as these are significant factors influencing the investment climate in the Bank's countries of operation. Key efforts in this regard include strengthening the policy dialogue with governments by agreeing on necessary improvements. Important high-level venues for this dialogue are the Foreign Investment Advisory Councils in Russia, Ukraine and Kazakhstan. They bring together government ministers, political leaders from the Bank's countries of operation, representatives of the international business community and high-ranking EBRD officials twice yearly to discuss how to improve the investment climate in the countries.

The transition countries, like most emerging economies, face significant challenges in improving transparency and governance. As required by its statutes (Article 1 of the Agreement Establishing the European Bank for Reconstruction and Development), the Bank reviews on an annual basis each country's progress towards multi-party democracy and pluralism. These principles, effectively implemented, contribute to transparency in government policy making and act as a check on corruption. Canada fully supports this approach.

In 2001 two countries were found to be weak in meeting their obligations under Article 1: Turkmenistan and Belarus. In both cases an Interim Strategy was approved that limited the Bank's involvement in the countries to the private sector until political reforms were forthcoming and the governments demonstrated a greater commitment to economic reform. In the case of Belarus, when the Interim Strategy was approved in April 2001, EBRD President Jean Lemierre wrote a letter to Belarus President Alyaksandr Lukashenko expressing his strong concern regarding Belarus' lack of commitment to Article 1. This letter was posted on the EBRD's Web site. It was agreed that the Interim Strategy would be reviewed after the September presidential elections. This review is currently underway.

The EBRD seeks to improve governance and transparency largely through the projects it undertakes. Equity investments have been an important tool in this regard. The Bank's participation on the boards of directors of companies in which it invests has been instrumental in improving the transparency of their accounting and business practices and their respect for minority shareholder rights. It is hoped that the success of these companies will demonstrate the importance of applying similar practices more broadly in the region. In addition, all Bank counterparts are examined to ensure they meet the highest standards of business practice. The Bank now routinely seeks the services of forensic accountants and specialized firms to perform integrity checks on potential investee companies and their management and shareholders. For those doing business with the EBRD, the EBRD's public procurement rules underline the standards of ethics and conduct required during the procurement and execution of EBRD-financed projects.

The Bank's work in the area of legal transition also plays an important role in addressing issues of corruption and poor governance. Under its Legal Transition Programme, the Bank has worked to improve the legal environment in its countries of operation by advancing legal reform in six areas: bankruptcy, company law/corporate governance, concessions, financial market regulation, secured transactions and telecommunications. In addition, the Bank has participated in international standard-setting efforts, including the World Bank's Insolvency Initiative, which seeks to develop international principles of bankruptcy, and the Financial Stability Forum's efforts to co-ordinate the development and implementation of international financial standards. The Bank also initiated a project with the Russian Federal Commission for the Securities Market to develop a Corporate Governance Code and helped the CIS Inter-Parliamentary Assembly draft a model securities law. To promote transparency the EBRD publishes an annual survey of the extensiveness and effectiveness of various commercial laws in the region in its legal journal, *Law in Transition*.

Enhancing Institutional Transparency, Accountability and Governance

Public Information Policy – In 2000 the EBRD modernized its Public Information Policy to broaden significantly the scope of information that the Bank makes available to the public. The policy is based on the presumption that information about Bank activities should be made public in the absence of a compelling reason for confidentiality. The following documents are now made available to the public, with commercially sensitive information deleted as required: draft sectoral policies (for public comment); final sectoral policies; Board-approved country strategies following consultation with the country concerned; summaries of medium- and long-term operational strategies; executive summaries of environmental impact assessments for public and private sector projects; and reports on public sector projects (on a request basis). The policy requires management to report annually to the Board on the implementation of the Public Information Policy, which was done in July 2001. These findings are made available on the Bank's Web site.

Canada welcomes this policy as a marked improvement over the previous public access and disclosure of information policy. In all international financial institutions (IFIs) in which it is a member, Canada has been at the forefront of efforts to improve transparency and accountability.

Shipping Operations and Property Policies – New policies were approved in 2001 for operations in the shipping sector and in the property sector. In line with the Public Information Policy, drafts of both policies were posted for 45 days on the EBRD's Web site and public comments were taken into account when the policies were finalized.

Manager of Outreach/NGO Relations – The Manager of Outreach/NGO Relations serves as a point of contact between the Bank and the NGO community, as well as other stakeholders and interested person. This position was created and staffed in 2001.

Chief Compliance Officer – The Chief Compliance Officer is responsible for promoting good governance within the Bank and ensuring that all employees respect the highest standards of business integrity. The Chief Compliance Officer has developed a training program for EBRD nominees to boards of directors of those enterprises in which the Bank has invested to ensure the nominees are fully aware of their responsibilities and possible actions that could breach the Bank's integrity. The Chief Compliance Officer also provides guidance to EBRD management and staff on appropriate behaviour and helps to develop Bank policies and procedures regarding misconduct.

Encouraging Partnerships

The EBRD is required by its founding agreement to involve outside sources of financing in its operations. By virtue of its guarantees to a project, the Bank can play a key role in attracting co-financiers that might not otherwise be willing to invest in the region. Co-financing has the benefit of increasing a country's access to international capital markets, promoting foreign direct investment and allowing appropriate risk sharing. The EBRD's main co-financing partners are commercial banks, government agencies, export credit agencies and other IFIs. In 2001 the EBRD worked with 62 commercial banks from 21 countries on 33 projects, for a total co-financing of nearly €2 billion.

The EBRD also works with donor countries to provide financing for institution building and technical co-operation. Such funding has played a significant role in promoting transition.

Where possible, the EBRD also works with other IFIs in order to extend the impact of the Bank's financing and to benefit from complementarities with the other institutions. In 2001 the EBRD worked with other IFIs on 18 projects involving €489 million in co-financing. Key partners for the EBRD included the World Bank, the Asian Development Bank, the European Investment Bank and the International Finance Corporation.

Canada has encouraged greater co-operation and co-ordination among multilateral development banks and is pleased with the efforts of the EBRD to work more closely with its sister institutions, where possible.

Changes in Senior Management

The Bank appointed a new First Vice President of Banking in 2001, Noreen Doyle, who assumed her responsibilities in September 2001. Prior to this appointment, Ms. Doyle was the EBRD's Deputy Vice President, Finance. Steven Kaempfer was reappointed Vice President, Finance. Ayesa Shah was appointed the new Treasurer in early 2002. Dorina Calorianu was appointed the first Manager of Outreach/NGO Relations.

New Members

The Bank expanded its membership to include FR Yugoslavia in January 2001.

Canadian Priorities in 2001

Canada is a strong supporter of the Bank's medium-term operational priorities, which are premised on: (1) the central importance of creating and strengthening those institutions – administrative, behavioural and financial – that ensure markets work well and (2) the key role that small businesses can play in creating dynamic, competitive and more equitable economies. These are key challenges facing all the countries in transition, particularly those in the CIS and Southeastern Europe. Canada supports the Bank's focus on:

- developing sound financial sectors linked to the needs of enterprises and households;
- providing leadership for the development of microlending and SMEs;
- developing market-based and commercially oriented infrastructure;
- demonstrating, through selected examples, effective approaches to restructuring viable large enterprises;
- taking an active approach in its equity investments to improve corporate governance;
- engaging governments in policy dialogue to strengthen institutions and improve the investment climate;
- taking a regional approach where appropriate; and
- promoting sustainable development and environmental due diligence.

The issue of accession to the EU by some of the EBRD's countries of operation and the role, if any, the EBRD might continue to play in those countries are key questions that will need to be addressed over the next two to three years. Indeed, one measure of the Bank's success could be considered to be the number of countries that make the successful transition to a market economy and no longer need its financing.

The EBRD is the only multilateral financial institution that has an explicit requirement that its members be committed to and apply principles of multi-party democracy and pluralism. Canada supports this requirement and believes it is appropriate for the Bank to limit its participation to the private sector in those countries not living up to their Article 1 commitments.

Promoting a multilateral rules-based trading system is also a key Canadian priority, and many of the Bank's activities work to support the integration of the transition countries into the world trading system.

The EBRD is committed to working closely and co-operatively with other IFIs and donors in the region. Canada strongly supports this approach. Co-ordination with other IFIs and donors is an important determinant of the EBRD's effectiveness in promoting the transition to a market economy. Further, the role of other IFIs in addressing poverty directly can complement the EBRD's work in the region.

Managing Canada's Interests

Role of Governors – The highest authority in the Bank is the Board of Governors. A Governor and an Alternate Governor represent each member country. The Honourable Paul Martin, Minister of Finance, is the Canadian Governor and Mr. Gaëtan Lavertu, Deputy Minister of Foreign Affairs, is the Alternate Governor.

Role of the Board of Directors – The Board of Directors, which is responsible for the general operations of the Bank, is composed of 23 members, of which 4 are non-European members. Canada is the third largest non-European shareholder, after the United States and Japan, and by virtue of its share has the right to elect its own Director. Canada also represents Morocco at the Bank. The Canadian Director was Patrice Muller until September 1, 2001. Mr. Muller was succeeded by Scott Clark. The Minister (Economic/Commercial) at the Canadian High Commission in London, David Plunkett, is the non-resident Alternate Director and represents Canada in the absence of the Canadian Director.

Role of Canadian Government Departments – Within the Canadian government, responsibility for oversight of the EBRD's activities resides with the International Finance and Economic Analysis Division of the Department of Finance. In consultation with the Department of Foreign Affairs and International Trade and CIDA, the Department of Finance regularly reviews the Bank's policy papers and proposed country strategies and provides advice to the Canadian Director.

Functions of the Canadian Director – In addition to participating in regular Board meetings, the Canadian Director is a member of the Financial and Operations Policies Committee, which reviews financial policies, including the Bank's borrowing policy, general policies relating to operations, and procedures and reporting requirements. Until the change in Director, the Canadian Director was also a member of the Budget and Administrative Affairs Committee, which considers general budgetary policy, proposals and procedures, as well as personnel, administrative and organization matters, including administrative matters relating to Directors and their staff.

Positions Taken in 2001 – The Canadian Director has frequently spoken to the Board on the importance of the Bank's charter requirement that member countries be committed to market reform and multi-party democracy.

To ensure EBRD operations remain additional and contribute to the transition process, Canada continued to advocate increased Bank efforts to find sound projects in those countries in the early and intermediate stages of transition that respect the principles of multi-party democracy and are making efforts at reform. In our view, only by focusing on quality will the Bank contribute to advancing transition in these countries. In the advanced transition countries, Canada has underlined the need for Bank financing to be additional, as the Bank's Articles of Agreement state that it should not displace financing available from the private sector on reasonable terms. Therefore we have urged the Bank to be innovative by seeking out niche activities and developing new financial products in the advanced transition countries where private sector financial and capital markets are increasingly active.

Canada has also been a strong proponent of greater EBRD transparency and shareholder accountability, believing that the Bank should be a model of behaviour for the region; thus it supported the revision of the Public Information Policy. Canada has also strongly supported measures to strengthen internal governance at the Bank to ensure that all staff function at the highest standards of business integrity, as well as efforts to strengthen the budget process.

Canadian Staff at the EBRD – Canadians are well represented on EBRD staff. At the end of 2001 there were 24 Canadian professionals on the staff of the EBRD, representing about 4 per cent of total professional positions, which slightly exceeds Canada's 3.4-per-cent share of the institution's capital. It is noteworthy that a Canadian heads the Baltic Team and another Canadian is Director of Communications.

Canada's Voting Record

Canada and other shareholders typically raise concerns and questions about specific Bank operations before they get to the Board. As a result, decisions at the Board are generally taken by consensus. Directors may, however, abstain or vote against projects as determined by consultations with their constituencies. The Canadian Director abstained or voted against the following policies and projects in 2001:

- He abstained on a subordinated loan of between €12.4 million and €24.9 million to Lukas Bank (Poland) because of concerns about low additionality of the Bank's resources.
- He voted against a US$25-million loan to ISTIL, a Ukrainian steel mill. Canada has always expressed the opinion that oversupply in the sector should be addressed in a comprehensive, multilateral manner.

Canadian Commercial Interests

The EBRD offers a number of investment opportunities for Canadian businesses and financial institutions. A key task of the Canadian Office is to increase Canadian awareness of these investment opportunities, explain how the Bank's financing mechanisms work, and ensure that EBRD policies and procedures are followed in a transparent and fair manner.

To achieve these objectives, the Canadian Office provides EBRD market information and intelligence to Canadian firms and advises Canadian project sponsors on EBRD financing options. In addition, the office develops commercial co-financing opportunities with Export Development Canada and other Canadian financial institutions. Together with the Department of Foreign Affairs and International Trade and Industry Canada, the office also identifies EBRD procurement opportunities and, with CIDA, promotes Canadian technical co-operation activities and official co-financing with the EBRD.

In 2001 the EBRD's Board of Directors approved EBRD participation in two Canadian-sponsored transactions. The aggregate size of these two projects is €169.4 million (C$238.5 million), of which EBRD financial commitments are €62.3 million (C$87.7 million). A description of the transactions is given in Annex 2. Additionally, in 2001 a Canadian bank acted as a lead arranger of a major EBRD syndicated loan in Central Europe, which was the first time a Canadian financial institution participated in the EBRD's syndicated loan program since the Russian financial crisis of 1998. Details of this transaction are also included in Annex 2.

With respect to official co-financing and technical co-operation, in 2001 the EBRD committed €3.7 million (C$5.2 million) from the CIDA-EBRD Cooperation Fund for Southeastern Europe to co-finance Bank transactions in the railway sector in Bosnia and Herzegovina and FR Yugoslavia. Procurement of goods and services under this arrangement commenced in the second half of 2001 and is limited to Canadian firms. In addition, Canadian consultants were awarded €345,816 (C$486,909) in EBRD technical co-operation and TurnAround Management assignments in 2001 to assist the Bank with energy efficiency in Poland and telecommunications regulatory reform, airport modernization and shipbuilding restructuring in Russia.

Looking forward, the EBRD hopes to increase the number of high-quality Canadian project sponsors with whom it invests to better align its official co-financing and technical co-operation needs with Canadian interests in the region, and to strengthen its partnership with Export Development Canada and other Canadian commercial co-financiers.

Promoting Canada's Interests

Members of the Canadian Office made five visits to Canada in 2001 to meet with business people, conduct seminars, speak at conferences and consult with government officials. This included the Canadian Director meeting with Canadian businesses and financial institutions in Toronto. In addition, the Assistants to the Director promoted the EBRD to the Canadian business community through meetings with: representatives of the mining industry at the Annual Meeting of the Prospectors and Developers Association of Canada in Toronto in March; representatives of the Canadian oil and gas industry in Calgary; and a large number of Canadian firms in Montréal and Toronto from a wide range of sectors, as part of a stronger EBRD marketing initiative in Canada. One of the Director's Assistants also took part in presentations of the EBRD 2001 *Transition Report* to business people and academics in Toronto and to government authorities in Ottawa in November.

The Canadian Office met with approximately 140 Canadians during 2001, including business people, representatives of financial intermediaries, government representatives (from all three levels of government), NGOs, consultants and academics.

Canada's commercial interests in the region were also promoted by:

- the Canadian Director working with the Canadian missions in Moscow and St. Petersburg in preparation for the Team Canada visit to Russia in 2002;
- the participation of the Canadian Director's Assistant in a commercial mission to Hungary, organized by the World Trade Centre in Montréal and led by the Mayor of Montréal, which focused on municipal and environmental infrastructure; and
- attendance of the Director's Assistant at the inaugural Canada-Poland Gas and Energy Forum in Warsaw, which was organized by Export Development Canada and the Canadian Embassy in Warsaw.

Challenges Ahead

In assisting its countries of operation over the second decade of transition, the EBRD will face significant challenges in expanding and managing its portfolio. In the advanced transition countries, which are increasingly able to obtain private sector financing, the Bank will have to develop new products and activities in order to remain additional. In the early and intermediate transition economies and Russia, the challenge will be to find quality projects in a high-risk environment that is characterized by a lack of market-supporting institutions. Over the coming decade the Bank will have to work in close partnership with other international financial institutions to address these challenges. Expanded co-operation with these institutions will also be necessary to develop high transition impact projects with explicit social and poverty alleviation benefits in order to strengthen the willingness of governments in the region to move forward with politically difficult but essential reforms, particularly the restructuring or closure of large enterprises.

Good governance continues to play a critical role in the future success of the region. Good corporate governance is one key aspect of this role. The state also has a strong role to play in supporting an enabling investment climate by promoting sound institutions, administering tax collection and improving legal and regulatory frameworks. It must ensure not only that appropriate legislation is developed, but also that it is properly implemented and enforced.

The first decade of transition has provided clear lessons for the future. Countries that have achieved more rapid and comprehensive reforms – particularly in liberalizing markets and trade, respecting government budget constraints and fostering the private sector by removing obstacles to the entry and exit of enterprises – have laid solid foundations for sustaining progress in reform. In these economies market-supporting institutions have tended to develop. These institutional frameworks – predictable fiscal and regulatory environments, secure property rights, an impartial judiciary and sound financial supervision and regulation – combined with appropriate macroeconomic policies, are laying the foundation for sustained rapid growth and increased access to international capital markets.

In contrast, in some countries in the Bank's region of operation, particularly those further east, progress in putting in place the institutions that underpin a market economy has been limited, and the process of liberalization and privatization is far from complete. As a result, economic growth remains vulnerable to external and internal shocks. In addition, the significant increase in poverty and inequality since the start of transition has eroded support for necessary reforms in many countries. Overcoming resistance to reform will be a challenge; it will require creating new employment opportunities and social fallback options for those displaced by structural change and breaking the hold of powerful vested interests over the reform process.

Contacting the Office of the Director for Canada

The Canadian Director's office at the EBRD may be reached at:

Office of the Director for Canada and Morocco
European Bank for Reconstruction and Development
One Exchange Square, Room 8.15
London, EC2A 2JN
United Kingdom

Mr. C. Scott Clark, Director	Tel:	+44 20 7338 6457
Mr. David Plunkett, Alternate Director[1]	Tel:	+44 20 7338 6507
Ms. Julie Fujimura, Director's Assistant[2]	Tel:	+44 20 7338 6458
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	Internet address:	kujawaa@ebrd.com

[1] Resident at the Canadian High Commission in London.

[2] Responsible for policy matters.

[3] Responsible for business development and investor liaison.

For More Information on the EBRD

The Bank releases considerable information on its various activities. Bank publications include information guides (such as *Financing With the EBRD*), special reports (such as the *Annual Report and Transition Report*), country strategies and assorted fact sheets.

Information can also be obtained on the Bank's Web site:

http://www.ebrd.com/

Requests for information can be addressed to:

Publications Desk
European Bank for Reconstruction and Development
One Exchange Square
London, EC2A 2JN
United Kingdom
(Fax: +44 20 7338 7544)

Annex 1

The Bank's Financial Activities

The Bank's financial activities are divided into ordinary and special operations, depending on the source of funds. Ordinary operations are financed from the ordinary capital resources of the Bank, which comprise subscribed capital, market borrowings and income from loans and investments. Special operations are those financed by "special funds" for specially designated purposes that are typically outside the Bank's regular activities. Unlike other regional development banks, however, the EBRD does not operate a concessional or "soft" loan window.

Ordinary Capital Resources

At the end of 2001 the total authorized capital of the Bank was €20 billion (C$28 billion). Canada has subscribed to 3.4 per cent – or €680 million (C$958 million) – of the Bank's authorized capital. Canadian contributions to the Bank's capital are made in US dollars (at a pre-determined euro/US$ exchange rate).

In 2001 Canada made its fourth purchase of shares under the first capital increase (which came into effect on April 3, 1997, and doubled the initial €10-billion capital base). Under the first capital increase 77.5 per cent of Canada's share is "callable," meaning that the Bank can request these resources in the unlikely event that it requires them to meet its financial obligations to bondholders; the balance, or 22.5 per cent, is "paid-in." Payments are being made in eight equal annual instalments of US$12,145,331.25 (40 per cent in cash and 60 per cent in non-interest-bearing demand notes encashed over five years). Under the initial capital, 30 per cent was paid-in over five years (split evenly between cash and notes encashed over a three-year period) and 70 per cent was callable. Canada completed payments for the initial capital in April 1997. The table on the next page details Canadian payments to the Bank in US dollars.

Canada's contributions to the Bank's capital are non-budgetary expenditures because our shares in the Bank are considered an asset. Nonetheless, Canada's contributions to the Bank do increase the Government's borrowing requirements.

Canadian Payments to the EBRD

Year	Notes	Cash	Encashment of notes	Total cash outlay
		(in US dollars)		
1991	11,903,502	11,903,502	11,903,502	23,807,004
1992	11,903,502	11,903,502	3,967,834	15,871,336
1993	11,903,502	11,903,502	7,935,668	19,839,170
1994	11,903,502	11,903,502	11,903,502	23,807,004
1995	11,903,502	11,903,502	11,903,502	23,807,004
1996	–	–	7,935,668	7,935,668
1997	–	–	3,967,834	3,967,834
1998	7,287,198	4,858,132	1,457,440	6,315,572
1999	7,287,198	4,858,132	2,914,879	7,773,011
2000	7,287,198	4,858,132	4,372,319	9,230,451
2001	7,287,198	4,858,132	5,829,759	10,687,891
Total	88,666,302	78,950,038	74,091,907	153,041,945

Market Borrowings

At the end of 2001 total outstanding debt was €11.5 billion (C$16.2 billion) with an average maturity of 9.4 years at an average cost of funds of LIBOR (London Inter-Bank Offered Rate) minus 30 basis points. Funds have been swapped into floating-rate instruments, primarily in US dollars, euros and Deutsche Marks.

Standard & Poor's has assigned the Bank an AAA long-term and A1+ short-term credit rating. Moody's Investors Service has similarly rated the EBRD long-term bonds AAA.

Special Funds

The EBRD administers a number of bilateral and multilateral technical assistance funds. Canada has contributed to the following special funds:

The Canadian Technical Cooperation Fund – The main purpose of this fund is to provide financing to hire Canadian consultants for EBRD projects. Canada has contributed C$12.65 million since the fund was established in 1992.

Chernobyl Shelter Fund – The main purpose of this fund is to secure the sarcophagus around the destroyed Unit IV nuclear reactor in Ukraine. The total estimated cost of this eight-year project is US$768 million, of which US$716 million has been pledged so far. Canada has pledged US$33 million, including US$0.8 million of bilateral assistance for ventilation stack repair.

Nuclear Safety Account (NSA) – This facility was established in 1993 to help finance the closure of the Chernobyl nuclear power plant and to improve safety conditions at nuclear power plants in countries of operation until the plants can be closed. The NSA complements other bilateral and multilateral nuclear safety technical assistance and functions in parallel with multilateral efforts to achieve broader energy sector reform in the region. Canada has contributed C$19.5 million to the total fund of €261 million (C$367.5 million).

Russia Small Business Fund (RSBF) – The purpose of this fund is to establish a facility for small business finance and microlending in various regions of Russia. The RSBF was established in 1993 as a pilot project and became permanent in 1995. Canada has contributed C$11.3 million towards the US$300-million fund.

CIDA-EBRD Cooperation Fund for Southeastern Europe (CFSEE) – In support of the EBRD's South Eastern Europe Action Plan, CIDA has contributed C$8 million for technical co-operation and co-financing activities in Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FYR Macedonia, Romania and FR Yugoslavia (Kosovo, Montenegro and Serbia). Of this amount, C$6 million has been made available to the EBRD through the CFSEE for technical co-operation and co-financing tied to Canadian consultants and suppliers. The remaining C$2 million has been provided to the EBRD for untied co-financing of critical investment projects under the Bank's Balkan Region Special Fund.

TurnAround Management Programme – The TurnAround Management Programme was established in 1993 to match senior industrial advisors from market-driven economies with chief executives of selected firms in the region. The objective is to provide industrial management know-how and develop business skills so that these companies can become competitive and profitable. In 1999 Canada made its first contribution of C$550,000 to this program, to be used to hire Canadian advisors.

Ukraine Micro Finance Bank (MFB) – In 2000 CIDA entered into a contribution agreement with the EBRD to provide C$1.25 million over two years for the provision of technical assistance related to the development of the MFB. The MFB will develop a branch network throughout Ukraine, with special attention being paid to Slavutych, the community where many former employees of the Chernobyl nuclear power plant reside. As a greenfield operation specializing in financial services for the micro and small enterprise sector, the MFB will also serve as a demonstration bank for the Ukrainian commercial banking sector to show the commercial viability of micro and small enterprise lending.

Technical assistance in support of the Ukraine Micro, Small and Medium-Sized Enterprises Line of Credit II – Between 1999 and 2003 CIDA will provide C$3 million for technical assistance services by qualified Canadian organizations to Ukrainian commercial banks receiving loans under the EBRD's Ukraine Micro, Small and Medium-Sized Enterprises Line of Credit II for on-lending to micro, small and medium-sized enterprises. The technical assistance will include risk- and loan-evaluation training.

Annex 2

EBRD – Canadian-Sponsored Project Activity in 2001

Date of Board approval	Canadian company	Project country	Project name	Type of financing	Sector	EBRD commitment (€ millions)	Total project cost (€ millions)
February 2001	Capcom (subsidiary of Caisse de dépôt et placement du Québec)	Regional	TIME Capital Communications Fund	Equity	Tele-communications, informatics and media	53.4	160.2
November 2001	High River Gold Mines Ltd.	Russia	Buryatzoloto Power Line	Corporate loan	Natural resources	8.9	9.2
Total						62.3	169.4

EBRD – Canadian Commercial Co-Financing in 2001

Date of Board approval	Canadian co-financier	Project country	Project name	Type of financing	Sector	EBRD commitment (€ millions)	Total project cost (€ millions)
July 2001	Canadian Imperial Bank of Commerce (acting as a lead arranger)	Hungary	Vivendi Telecom Hungary	Syndicated debt	Tele-communications, informatics and media	100.0	350.0

Annex 3

Doing Business With the EBRD

General inquiries about working with the EBRD should be directed to the Office of the Director for Canada or to the Bank's Communications Department in London (tel: +44 20 7338 6096; fax: +44 20 7448 6690).

Canadian Project Sponsors: Canadian companies interested in potentially sponsoring a project with the EBRD are requested to direct initial inquiries either to Project Inquiries in London (tel: +44 20 7338 6282 or +44 20 7338 6252; fax: +44 20 7338 6102) or to the Bank's resident office in the country of operation. Summaries of EBRD private sector operations can be obtained on the Bank's Web site at http://www.ebrd.com/.

Canadian Suppliers of Goods and Works: The EBRD makes available information on all stages of public sector project development, from the point a project has been identified by the Bank through to its approval. Procurement opportunities and co-financing notices, as well as contract awards information, can be accessed on the Bank's Web site free of charge (see address above).

Canadian Consultants: The EBRD's Web site contains technical co-operation notifications and invitations for expressions of interest for consultancy services pertaining to both public and private sector projects. The EBRD also makes use of the World Bank's electronic Data on Consultants (DACON) registration system. Although it is not required for consultants to register with DACON to be eligible for EBRD assignments, it is nonetheless advisable as it is a useful marketing tool. Requests for DACON registration packages should be sent directly to:

DACON Information Centre
World Bank
1818 H Street
Washington, DC 20433 USA

Individual Canadians: The EBRD maintains a recruitment section on its Web site, which provides information on specific employment competitions at the Bank as they become available. In general, applications for employment for both permanent positions and summer jobs should be sent to:

Franco Furno, Director for Human Resources
Human Resources Management Department
European Bank for Reconstruction and Development
One Exchange Square
London, EC2A 2JN
United Kingdom

Annex 4

EBRD Membership as at December 31, 2001

	Share of the Bank's capital		Share of the Bank's capital
	(%)		(%)
European Members		**Countries of Operation**	
Austria	2.28	Albania	0.10
Belgium	2.28	Armenia	0.05
Cyprus	0.10	Azerbaijan	0.10
Denmark	1.20	Belarus	0.20
Finland	1.25	Bosnia and Herzegovina	0.17
France	8.52	Bulgaria	0.79
Germany	8.52	Croatia	0.36
Greece	0.65	Czech Republic	0.85
Iceland	0.10	Estonia	0.10
Ireland	0.30	FR Yugoslavia	0.47
Israel	0.65	FYR Macedonia	0.07
Italy	8.52	Georgia	0.10
Liechtenstein	0.02	Hungary	0.79
Luxembourg	0.20	Kazakhstan	0.23
Malta	0.01	Kyrgyzstan	0.10
Netherlands	2.48	Latvia	0.10
Norway	1.25	Lithuania	0.10
Portugal	0.42	Moldova	0.10
Spain	3.40	Poland	1.28
Sweden	2.28	Romania	0.48
Switzerland	2.28	Russia	4.00
Turkey	1.15	Slovak Republic	0.43
United Kingdom	8.52	Slovenia	0.21
European Union	3.00	Tajikistan	0.10
European Investment Bank	3.00	Turkmenistan	0.01
		Ukraine	0.80
		Uzbekistan	0.21
Non-European Members			
Australia	0.50		
Canada	**3.40**		
Egypt	0.10		
Japan	8.52		
Korea, Republic of	1.00		
Mexico	0.15		
Mongolia	0.01		
Morocco	0.05		
New Zealand	0.05		
United States	10.00		

Report on Operations Under the European Bank for Reconstruction and Development Agreement Act

2002

Canadä

Report on Operations Under the European Bank for Reconstruction and Development Agreement Act 2002

Prepared by:
International Trade and Finance Branch
March 2003

Department of Finance Canada   Ministère des Finances Canada

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Introduction

The European Bank for Reconstruction and Development (referred to in this document as the EBRD or the Bank) was established in 1991. Its aims are to foster the transition towards open, market-oriented economies in Central and Southeastern Europe, as well as in the successor states of the former Soviet Union, and to promote private and entrepreneurial initiative in those countries that are committed to the fundamental principles of multi-party democracy, pluralism and a market economy (see Annex 4 for a list of the EBRD's 27 countries of operations).

The EBRD differs from other regional development banks in four ways. First, its overriding focus is the private sector and support for the transition from central planning to stable market economies. Its charter stipulates that not less than 60 per cent of its financing commitments should be directed either to private sector enterprises or to state-owned enterprises implementing a program to achieve private ownership and control. Second, it has a particular focus on the promotion of democratic institutions and human rights in its countries of operations. Third, it is explicitly committed under its Articles of Agreement to ensuring the environmental sustainability of all its projects. Fourth, the EBRD does not provide concessional financing.

The Bank seeks to help its 27 countries of operations to implement structural and sectoral economic reforms, taking into account the particular needs of countries at different stages in the transition process. In particular, its private sector activities focus mainly on enterprise restructuring, including the strengthening of financial institutions, and the development of infrastructure needed to support the private sector. The EBRD has 62 members: 60 countries, the European Union (EU) and the European Investment Bank (see Annex 4 for a list of members).

Canada is the eighth largest shareholder (tied with Spain), following the other Group of Seven (G-7) countries and Russia. Our formal participation is authorized under the European Bank for Reconstruction and Development Agreement Act, which was promulgated in February 1991. Article 7 of the Act states that:

> The Minister [of Finance] shall cause to be laid before each House of Parliament by March 31 of each year or, if that House is not then sitting, on any of the thirty days next thereafter that it is sitting, a report of operations for the previous calendar year, containing a general summary of all actions taken under the authority of this Act, including their sustainable development aspects within the meaning of Article 2 of the Agreement, and their human rights aspects.

This report responds to this requirement and reviews the activities and operations of the Bank for the year 2002.

Benefits of Membership

As a major trading nation, Canada has a stake in global peace and stability, which the successful integration of Central and Southeastern Europe and the former Soviet Union into the world economy and global institutions helps to promote. By fostering continued political and economic reform in the region, the EBRD is contributing to its integration into the world economy and to its stability.

The Minister of Finance is a Governor of the Bank and appoints a Director to its 23-member Board. This represesentation allows Canada to have high-level influence on decisions taken by the EBRD on investments in the region and on policies to move countries through the transition process. The EBRD also provides trade opportunities for the Canadian private sector, supporting a diversification of international markets for Canadian businesses.

The EBRD

- fosters the transition of former centrally planned economies of Central and Southeastern Europe and the successor states of the former Soviet Union towards market-oriented economies;
- promotes private entrepreneurial initiative by targeting at least 60 per cent of its resources to private sector projects, with the balance in support of commercially viable state sector projects that promote private sector development;
- operates only in countries committed to applying the principles of multi-party democracy, pluralism and market economics;
- promotes environmentally sound and sustainable development; and
- operates on a self-financing basis.

Role and Mandate of the EBRD

The EBRD's operations to advance the transition to a market economy are guided by three principles: maximizing transition impact, additionality and sound banking. Financing is provided for projects that expand and improve markets, help to build the institutions necessary for underpinning a market economy, and demonstrate and promote market-oriented skills and sound business practices. EBRD financing must also be additional to other sources of financing and not displace them, further ensuring that the Bank contributes to the transition process. Finally, Bank projects must be sound from a banking perspective, thus demonstrating to private investors that the region offers attractive returns. Adherence to sound banking principles also helps to ensure the financial viability of the EBRD and hence its attractiveness as a co-investment partner for the private sector.

In promoting economic transition in its countries of operations, the Bank acts as a catalyst for increased flows of financing to the private sector. The capital requirements of these countries cannot be fully met by official multilateral or bilateral sources of financing, and many foreign private investors remain hesitant to invest in the region, particularly the central Asian republics. By providing an umbrella under which wider funding for private sector investment can be assembled, the EBRD plays a catalytic role in mobilizing capital. In 2002, for every euro the EBRD invested, it mobilized an additional 1.2 euros from the private sector and other multilateral and bilateral agencies.[1]

Indeed, the projects of the Bank serve a dual purpose. They are intended not only to directly support the transition from a command to a market economy in countries of operations, but also to create a demonstration effect to attract foreign and domestic investors. Like the World Bank Group's International Finance Corporation, the Bank is required to operate on a strictly commercial basis and to attract companies through financially viable projects, not through subsidies.

[1] On December 31, 2002, one euro purchased 1.6568 Canadian dollars.

Key Economic Developments in 2002

Real gross domestic product (GDP) growth in the majority of transition economies slowed in 2002. However, most countries in the region performed fairly well in comparison with other emerging markets, especially given the backdrop of a sluggish global economy. As in the previous two years, real GDP growth for the region as a whole was mainly driven by the Commonwealth of Independent States (CIS) and Southeastern Europe.[2]

The CIS continued to reap the benefits of high oil and gas prices in 2002. The region's largest economy, Russia, recorded an estimated real GDP growth rate of 4.3 per cent in 2002, its fourth year of sustained growth since its financial crisis in 1998. In Southeastern Europe growth in 2002 was slightly down from 2001, but improved regional cooperation and enhanced integration with the EU are indicative of a favourable outlook. Real GDP growth in Central Europe[3] slowed to just over 2 per cent in 2002, the lowest rate since economic recovery began in the region in 1994. This slowdown reflected in part weaker growth in the EU, the main market for the region's exports.

The following table ranks transition countries by their progress in moving to a market economy, based on a number of indicators.

[2] The CIS includes Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan. Southeastern Europe includes Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the Former Yugoslav Republic of Macedonia (FYR Macedonia), Romania, and the Federal Republic of Yugoslavia (FR Yugoslavia), which became a member of the Bank in early 2001. Kosovo is a province of FR Yugoslavia.

[3] Includes the Czech Republic, Hungary, Poland, the Slovak Republic, Slovenia and the three Baltic States (Estonia, Latvia and Lithuania).

Progress in Transition in EBRD Countries of Operations

Countries	Population (millions, mid-2001)	Private sector share of GDP in %, mid-2001 (EBRD estimate)	Enterprises: Large-scale privatization	Enterprises: Small-scale privatization	Enterprises: Governance and enterprise restructuring	Market and trade: Price liberal-ization	Market and trade: Trade and foreign exchange system	Market and trade: Compe-tition policy	Financial institutions: Banking reform and interest rate liberalization	Financial institutions: Securities markets and non-bank financial institutions
Albania	3.4	75	2+	4	2	3	4+	2-	2+	2-
Armenia	3.8	70	3+	4-	2+	3	4	2	2+	2
Azerbaijan	8.1	60	2	4-	2	3	4-	2	2+	2-
Belarus	10.0	20	1	2	1	2	2+	2	2-	2
Bosnia and Herzegovina	4.3	45	2+	3	2-	3	3	1	2+	1
Bulgaria	8.1	70	4-	4-	2+	3	4+	2+	3+	2
Croatia	4.6	60	3	4+	3-	3	4+	2+	4-	2+
Czech Republic	10.3	80	4	4+	3+	3	4+	3	4-	3
Estonia	1.4	80	4	4+	3+	3	4+	3-	4-	3
FR Yugoslavia	8.6	40	2	3	2	3	3+	1	2+	1
FYR Macedonia	2.0	60	3	4	2+	3	4	2	3	2-
Georgia	5.4	65	3+	4	2	3+	4+	2	2+	2-
Hungary	10.0	80	4	4+	3+	3+	4+	3	4	4-
Kazakhstan	14.9	65	3	4	2	3	3+	2	3-	2+
Kyrgyzstan	4.7	60	3	4	2	3	4	2	2+	2
Latvia	2.4	70	3+	4+	3-	3	4+	2+	4-	2+
Lithuania	3.7	75	4-	4+	3	3	4+	3	3	3
Moldova	4.3	50	3	3+	2	3+	4+	2	2+	2
Poland	38.7	75	3+	4+	3+	3+	4+	3	3+	4-
Romania	22.3	65	3+	4-	2	3+	4	2+	3-	2
Russia	145.4	70	3+	4	2+	3	3	2+	2	2-
Slovak Republic	5.4	80	4	4+	3	3	4+	3	3+	2+
Slovenia	2.0	65	3	4+	3	3+	4+	3-	3+	3-
Tajikistan	6.2	50	2+	4-	2-	3	3+	2-	2-	1
Turkmenistan	5.4	25	1	2	1	2	1	1	1	1
Ukraine	49.3	65	3	4-	2	3	3	2+	2+	2
Uzbekistan	25.0	45	3-	3	2-	2	2-	2	2-	2

Note: The classification of transition indicators uses a scale from 1 to 4, where 1 implies little or no progress with reform and 4 implies a market economy. A rating of 4+ indicates the country has achieved standards and performance typical of advanced industrial economies.

Source: EBRD, 2002 *Transition Report*.

Russia

Russia was relatively unaffected by the global economic slowdown in 2002. Higher oil prices and prudent macroeconomic policies led to estimated real GDP growth of 4.3 per cent, down from 5.2 per cent in 2001. Higher-than-expected oil prices enabled the government to exceed its annual revenue target and to post a fiscal surplus for the third consecutive year (estimated at 1.8 per cent of GDP for 2002). The current account surplus shrank, but still remained large at 9 per cent of GDP (down from 11.2 per cent in 2001). This sizeable surplus and a reduction in capital flight allowed the central bank to increase its international reserves by US$11.4 billion during the year to US$47.9 billion. The central bank, however, lacked the instruments to sterilize such a large purchase of foreign exchange, which explains in part why year-end inflation, at 15.1 per cent, exceeded the government target of 14 per cent.

The Finance Ministry recently announced that its financial reserve fund ended 2002 at US$8 billion, nearly US$2 billion higher than planned. This fund, together with the projected US$20-billion current account surplus in 2003 and sizeable international reserves, should facilitate the service of Russia's external debt payment "hump" in 2003 (obligations are estimated at US$17 billion).

The key risk to Russia's economic outlook continues to be its dependence on international energy prices. Economic growth since the 1998 financial crisis has been mainly driven by the sharp real depreciation of the ruble and the upturn in oil prices, both of which contributed to a substantial increase in gross fixed investment in resource-based sectors.

In order to diversify its economy and reach a more sustainable growth path, Russia needs to attract more investment in the non-energy sector by implementing reforms aimed at improving the investment climate. Although authorities have made substantial efforts in implementing structural reforms in 2001 and 2002, their main challenge will be to maintain a similar pace in the face of the upcoming parliamentary elections in December 2003 and presidential elections in March 2004. Reforms that are vital to secure sustainable medium-term growth include financial sector reforms (reforming the banking sector, passing a law on deposit insurance and a law on currency regulation and currency controls), energy sector reform and the easing of the bureaucratic burden on the corporate sector.

Other CIS Countries

The other CIS countries also experienced slower economic growth in 2002, with the exception of countries rich in oil and gas resources, such as Kazakhstan. In Azerbaijan increased investment for the exploration and export of the country's hydrocarbon reserves also led to robust growth.

Real GDP growth in Ukraine is estimated to have slowed to 4.1 per cent in 2002, down from 9.1 per cent in 2001. This remained a fairly strong performance given that exports, which had been the main driver of the economic recovery of the two previous years, were hit by the global slowdown.

High growth rates in other CIS countries in recent years have been mainly driven by strong demand from the booming Russian economy and low capacity utilization, which allowed an increase in production without having to step up investment in fixed capital. Now that their room to manoeuvre in this regard is vanishing, CIS countries desperately need to increase domestic investment and attract foreign direct investment by improving their business environments.

Another challenge faced by Kyrgyzstan, Moldova, Tajikistan, Armenia and Georgia is that their debt levels remain very high despite various recent debt relief initiatives.

Central Europe

The economies of Central Europe showed considerable resilience in 2002, despite anemic growth in the EU. The growth rate of the whole region, however, did weaken slightly from the previous year.

With three quarters of exports destined to the EU, the Baltic States recorded a significant slowdown in 2002. Nonetheless, growth rates remained above those of other central European countries: real GDP rose 4.5 per cent in Latvia (down from 7.7 per cent in 2001), 5.2 per cent in Lithuania (down from 5.9 per cent) and 5.0 per cent in Estonia (same as 2001).

Poland continued its sluggish economic performance in 2002, with real GDP rising by an estimated 1.2 per cent (up from 1.0 per cent in 2001). This weak performance largely resulted from a combination of tight monetary policy and lax fiscal policy, which drove up interest rates. In the Czech Republic, real GDP growth was estimated at 2.5 per cent (down from 3.3 per cent in 2001), reflecting the economic damage from the floods in the summer of last year and reduced EU demand for the country's exports.

The governments of Hungary, the Czech Republic, the Slovak Republic and Poland continue to face significant challenges in terms of fiscal consolidation. They all ran substantial fiscal deficits in 2002. These deficits will need to be addressed in order to generate the fiscal room to manoeuvre that will be required to implement the EU's *acquis communautaire,* particularly given the expected deceleration in privatization revenues.

Accession to the European Union

Accession to the EU has been an important factor underlying economic and political reform efforts in Central Europe. At the Copenhagen Summit in December 2002, the EU reached agreement on a timetable for final accession for the first wave of candidate countries. The Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic and Slovenia are now expected to become full members of the EU in May 2004. At the same time, a roadmap was articulated for the eventual accession of Bulgaria and Romania.

The EBRD, European Commission and World Bank have signed a memorandum of understanding (MOU) setting out the basic principles for collaboration in supporting projects that will assist all accession countries in meeting the requirements of the EU. In particular, the accession countries face specific requirements for investment in infrastructure to meet the requirements of the EU's *acquis communautaire,* or inventory of EU laws and standards. The EBRD actively supports projects where its mandate and EU accession requirements overlap. The imminent accession of the first wave of candidate countries has raised important issues concerning the operationalization of the interagency MOU and its interaction with the graduation policies of the World Bank and EBRD.

The EU has also offered the prospect of eventual EU membership for the countries of Southeastern Europe through the Stabilisation and Association Process. Under this process, the EU has started to negotiate Stabilisation and Association Agreements with democratic, reform-minded countries in the region. The Agreements offer the prospect of better trade access, increased assistance for education and institution building, cooperation in the areas of justice and home affairs, formal political relations with the EU and, one day, membership in the EU. It is hoped that the prospect of EU membership will spur reform efforts in Southeastern Europe as it has done in Central Europe. Thus far the EU has entered into or completed negotiations to establish agreements with FYR Macedonia, Albania, Croatia, Bosnia and Herzegovina, and FR Yugoslavia.

Southeastern Europe

The outlook for Southeastern Europe is better than at any time since the breakup of the former Yugoslavia. Given the unfavourable external environment, real GDP growth in the region was impressive in 2002, albeit slightly weaker than in 2001.

The two EU accession candidates, Bulgaria and Romania, posted strong macroeconomic performances. Bulgaria's real GDP growth for 2002 is estimated at 4.0 per cent, the same as in 2001, while Romania's growth for last year is estimated at 5.0 per cent, down slightly from 5.3 per cent in 2001. The commitment by the European Commission to support these two countries for EU accession in 2007 is also likely to attract substantial capital inflows in the medium term.

In FR Yugoslavia[4] the economic outlook continued to improve in 2002, following achievements in economic stabilization and reform since late 2000. It is hoped that a strong commitment to the new constitutional framework will bring more stability and foster an increase in external trade and foreign direct investment. For Bosnia and Herzegovina and FYR Macedonia, however, investor confidence remained low as political uncertainty and ethnic tensions persisted. It remains to be seen if the new governments elected in late 2002 will be able to implement much needed structural reforms and improve their countries' business climates.

[4] FR Yugoslavia became Serbia and Montenegro in February 2003.

Canada's Co-operation With the EBRD in Southeastern Europe

In response to the Kosovo crisis in 1999, the EBRD developed the South Eastern Europe Action Plan (SEEAP), which seeks to promote investment and to assist in the economic recovery of the region. Eligible countries are Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FR Yugoslavia, FYR Macedonia and Romania.

Under the SEEAP, EBRD investments focus on developing commercial approaches to infrastructure (such as telecommunications, airports, and municipal and environmental infrastructure), small, medium and micro enterprises, and the financial sector. This focus reflects the transition challenges facing the region: crumbling infrastructure, a weak industrial asset base, mostly small, fragile banks and pervasive problems of poor governance.

In 2000 Canada created the Cooperation Fund for Southeastern Europe (CFSEE) in support of the SEEAP. In 2002 C$4 million was added to the C$6 million previously contributed, which is tied to the use of Canadian companies and consultants. One project was supported in 2002, bringing the total number of projects supported through the CFSEE to six, with a value of C$6.3 million. Three of these projects have targeted the transport sector, with the others focused on municipal infrastructure and capacity building.

In addition, Canada made an untied contribution of C$2 million to the Balkan Region Special Fund (BRSF) in 2000 to support priority investment projects in the region.

Canada's total contribution of C$12 million to the CFSEE and the BRSF is being used for technical assistance and co-financing related to project preparation and implementation, advisory services and capacity building. Our assistance has contributed to the efforts of both the EBRD and the international community in supporting the transition process and promoting stability in the region.

2002 *Transition Report*

The *Transition Report* is an annual publication of the EBRD that charts the progress of transition from a centrally planned to a market economy in each of the Bank's 27 countries of operations. Agriculture and rural transition were chosen as the theme of the 2002 report. This reflects the fact that—even though over a third of the population of the region lives in rural areas—rural issues have not featured prominently during the first decade of transition. This has been to the detriment of the transition process in rural areas. In view of the importance of the farm sector, reforming agriculture, increasing farm productivity and promoting land reform remain the dominant rural transition challenges. At the same time, rural areas also need to diversify their economic activities by promoting non-farm activity through the development of linkages with markets, financial institutions and other firms.

The report notes that many transition economies have experienced significant and persistent declines in agricultural output since the start of transition. A number of factors are cited as having contributed to this trend. Not surprisingly, the better performers have tended to be those with better starting conditions. Countries that have liberalized and privatized their economies to the greatest extent (including through the promotion of individual or household ownership of farms) have seen positive responses in the agricultural sector. The method of implementing land privatization has also had a clear impact on productivity, with countries following a restitution principle enjoying higher productivity. This may have been because land restitution provided owners with more clearly defined property rights than other methods of land privatization.

The EBRD also finds that progress in agricultural reform is strongly linked to the "methods of political decision-making." The greatest progress in agricultural reform has been made in stable democracies in which there are high levels of political competition and an active civil society.

Another transition country trend identified in the report pertains to the shift in agricultural trade patterns. In particular, it notes a substantial rise in agricultural trade deficits. This was partly a function of the fact that the transition countries trade primarily in "temperate zone" products such as grains, milk, butter and livestock, which tend to be the most protected commodities in global trade.

2002 Financial Results

The EBRD approved 102 projects in 2002, the same number as in the previous year. These commitments totalled €3.9 billion, up slightly from €3.7 billion in 2001. Cumulative commitments by the end of 2002 amounted to €21.6 billion. The level of disbursements, at €2.4 billion, was roughly the same as in 2001.

The EBRD earned a profit after provisions of €108.1 million, down from €157.2 million in 2001. In 2002 the Bank reviewed its provisioning and liquidity policies. This review confirmed the adequacy of existing policies. No significant changes were recommended.

The increasing access of the advanced transition countries to private capital and financial markets and the continued poor investment climate in many early and intermediate transition countries create a challenge for the Bank.[5] The Bank needs to continue to balance the requirement to follow sound banking principles with the need to provide transition assistance to countries where the investment climate is risky. The financial results for 2002 suggest that, so far, the Bank has managed to achieve this balance. The challenge over the coming year will be to maintain this balance in an environment of slow growth and geopolitical uncertainty.

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[5] Advanced transition countries include Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic and Slovenia. Early and intermediate transition countries include the balance of the EBRD's countries of operations, excluding Russia: Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, FR Yugoslavia, FYR Macedonia, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Romania, Tajikistan, Turkmenistan, Ukraine and Uzbekistan. Russia is considered to be in a category of its own by the EBRD.

The EBRD's general administrative expenses in 2002 were £142 million, comparable to those for 2001, reflecting continuing budgetary discipline, effective cost controls and a proactive cost-recovery program.

Financial Highlights

- Profits after provisions fell to €108.1 million, down from €157.2 million in 2001.[1]
- Total provisions on banking assets were €1.21 billion at the end of 2002, virtually unchanged from the end of 2001.
- The Bank made a record €3.9 billion of new investments in 2002 in 102 operations, a slight increase over 2001. This amount—which was well in excess of the objective of €2.9 billion—was evenly divided among advanced transition countries, early and intermediate transition countries, and Russia, with an annual business volume of €1.3 billion for each region. The figure for Russia represents a significant increase, up from €822 million in 2001 and resulting in the Bank's largest-ever business volume in Russia. The annual business volume in the early and intermediate transition countries increased slightly from 2001 levels, including a 25-per-cent increase in commitments in Southeastern Europe.
- Gross disbursements, at €2.4 billion, were roughly the same as in 2001.
- The Bank mobilized €1.2 in additional financing for every euro that it invested in 2002, down significantly from €2.7 in 2001.
- The private sector share of annual business volume was 71 per cent, down from 76 per cent in 2001.
- Administrative expenses, denominated in pounds sterling (the currency in which most of the Bank's expenses accrue), were £142 million, up slightly from 2001 and somewhat below budget.
- Capital expenditures totalled £11.2 million in 2002, of which £10.6 million related to information technology.
- Reserves[2] at the end of 2002 were €661.1 million, up from €488.7 million at the end of 2001. This reflected the profit for the year and an increase in the fair value of the Bank's listed share investments. At the end of 2002 approximately €240 million of total reserves represented unrealized capital gains. This is down from €300 million at the end of 2001.

[1] This reflects a "fair value adjustment" of €38.3 million required under international financial reporting standards, but does not reflect the underlying performance of the Bank during the year. Provisions for losses are subtracted from operating income along with other expenses. For private sector projects, which make up the bulk of the EBRD portfolio, provisioning follows a risk-based approach. Management continually reviews the portfolio to ensure that the current value of loans and investments reflects management's best estimate of the recoverability of Bank assets.

[2] Reserves are Bank capital set aside to cover unexpected losses.

Institutional Developments

Private Sector Development

A key part of the EBRD's work with the private sector is its support of micro, small and medium-sized enterprises (SMEs), which are important engines for job creation and growth, and therefore poverty reduction. Canada is a strong proponent of the private sector work of the Bank, recognizing that a strong private sector is key for the successful transition to a market economy. Canada views a strong SME sector as one means for developing a "constituency for reform" in the transition economies that can act as a counterweight to powerful vested interests that benefit from weak state governance.

The Bank's strategy for the SME sector is founded on three pillars: financing, improving the investment climate through policy dialogue, and developing business support networks for SMEs. The strategy explicitly recognizes that the poor investment climate, and not just limited access to financing, is a major impediment to the development of the sector. The strategy emphasizes the need to identify and promote the removal of the main obstacles to SME growth, as well as to encourage the development of strong business associations.

About 71 per cent of the EBRD's annual business volume in 2002 was in the private sector, down from about 76 per cent in 2001 and 78 per cent in 2000. Despite this decline, the ratio is well above the target of 60 per cent. In 2002 the EBRD continued to increase the number of credit lines for SMEs to financial intermediaries and expand its various small business programs throughout its countries of operations. Since the Bank's first small business program was established in 1994, more than 200,000 loans worth more than €1.5 billion have been disbursed. The EU/EBRD SME Finance Facility increased its funding for the loan and leasing aspects of the program to €575 million. By the end of 2002 the Bank had provided 36 credit lines to 31 financial intermediaries. As a result, over 12,300 loans worth €312 million have been extended to SMEs in the region, with an average loan size of €22,000. The repayment rate on these loans has been higher than 99 per cent. In 2002 the micro lending programs disbursed over €717 million through more than 144,000 micro and small loans.

Activities in the Financial Sector

Financial Sector Policy—The EBRD's financial sector policy takes a country-specific approach to financial sector development, focusing on the need to promote confidence and competition in an independent financial system. The EBRD seeks to strengthen confidence in the sector primarily by helping to improve local institutions' governance and business practices. It also tries to improve financial supervision and regulation, although its activities here are constrained by its investor role in the sector and potential concerns about conflict of interest. Nonetheless, as a reputable foreign investor

in the sector, the EBRD offers important insights on supervisory and regulatory requirements, which it shares with other international financial institutions operating in the region and with governments. To address competition and independence, EBRD investments attempt to increase the diversity of institutions and services available (particularly to the private sector and SMEs), facilitate foreign direct investment and strengthen the commercial orientation of state-owned financial institutions, particularly in preparation for privatization.

In 2002 the EBRD committed financing to 36 financial sector operations, bringing total EBRD exposure to the financial sector region-wide to €7 billion. Financial sector operations represent about 30 per cent of the EBRD's portfolio.

Banking Sector Activities—In 2002 the EBRD signed new loans valued at €541 million to the banking sector and took €311 million in new equity positions in local banks. In most cases where the EBRD holds an equity stake in a local financial institution, it is represented on the supervisory board of the institution, where it promotes management accountability, good corporate governance, sound banking practices and appropriate environmental reviews and procedures. Participation in bank privatizations is a key factor behind equity investments in early and intermediate transition countries.

Non-Bank Financial Institutions—During 2002 the EBRD also stepped up its activities in the non-bank financial sector. A total of seven new transactions were signed in the sector during the year, with new commitments of €166 million. The EBRD is one of the largest financial investors in this sector, with investments in local asset management and mutual fund companies becoming increasingly important as voluntary pension sectors in the Bank's countries of operations develop. By the end of 2002 the Bank had investments in the non-bank financial sector in most of the countries in the region, where necessary institutional and regulatory regimes had been or were in the process of being introduced.

Environment

Support for the environment remained a key priority in 2002, reflecting the Bank's mandate to ensure sustainable long-term development in its countries of operations. This goal was bolstered by its participation at the World Summit on Sustainable Development held in Johannesburg in September 2002. Apart from the initiatives to specifically redress environmental weakness, many EBRD projects include environmental targets—for example, to reduce atmospheric emissions and industrial wastewater discharges, and promote waste recovery, recycling and clean technologies.

The EBRD contributes to international initiatives such as the "Environment for Europe" process, including the Environmental Action Plan for Central and Eastern Europe, the Danube River Basin Strategic Action Plan, and the Helsinki Commission and the Global Environment Facility, for which it is an executing agency. In 2002 six projects were approved for support under the recently created Northern Dimension Environmental Partnership (NDEP). The NDEP (which consists of Russia, the EU, the EBRD, the Nordic Investment

Bank and the European Investment Bank) provides donor funding to address severe environmental problems in northwest Russia, particularly in the areas of nuclear waste, water and wastewater treatment, and energy efficiency. Within the framework of its mandate, the EBRD supports relevant multilateral and regional agreements on the environment and sustainable development, including the Framework Convention on Climate Change and the measures agreed to in the Kyoto Protocol.

The EBRD applies environmental due diligence to all its investment and technical cooperation operations. Project sponsors are required by the Bank to undertake environmental impact assessments, analyses and audits that address potential environmental, health and safety, and socio-economic impacts of projects. Environmental impact assessments and analyses are conducted when potential impacts are significant. Environmental audits are performed post-approval. In some cases both an audit and an assessment/analysis are performed. The EBRD also requires local financial intermediaries, through which it channels funds to micro, small and medium-sized enterprises, to adopt appropriate environmental policies and procedures. In 2002 the EBRD conducted 49 environmental analyses, 4 environmental impact assessments and 40 environmental audits on projects approved by the Board of Directors.

Municipal and Environmental Infrastructure

EBRD investments in this sector focus on upgrading local facilities, such as municipal wastewater treatment plants, and on raising the service levels of municipal and local utility companies. Reducing costs and increasing the reliability of municipal services can stimulate the development of commercial and industrial enterprises. At the same time, greater access to clean water and sanitation services improves public health and increases public confidence in the transition process and ongoing reform efforts.

Over the last few years the EBRD has increasingly relied on municipal, as opposed to sovereign, guarantees in this sector, providing local governments with important new financial opportunities and responsibilities. The EBRD's operations policy for municipal and environmental infrastructure emphasizes private sector involvement, the development of appropriate regulatory structures and improvements in energy efficiency.

In 2002 the EBRD provided financing of more than €558 million to 16 projects designed to improve municipal infrastructure and promote energy efficiency. The Bank also completed the first part of a study on the potential for renewable energy projects in its countries of operations.

Energy Sector Investments

Most of the EBRD's countries of operations suffer from severe economic and environmental problems caused by polluting energy systems and inefficient energy pricing. Under the updated Energy Operations Policy the Bank promotes energy efficiency through its operations. One of the revised policy's key objectives is to improve environmental performance, including meeting climate change objectives and supporting renewable forms of energy.

In 2002 the Bank was particularly active in the energy sector, supporting, among other things, the promotion of energy efficiency and the modernization of Russia's power network. €560 million was committed to projects in the energy sector, bringing cumulative commitments in this sector to over €2.3 billion. In this area the Bank seeks to work with governments to develop electricity tariffs that reflect costs while taking into account customers' ability to pay.

The EBRD and Nuclear Safety

Through the Nuclear Safety Account (NSA), Canada and other G-7 countries have continued to work closely with the EBRD to improve nuclear safety in countries of Central and Southeastern Europe and in the former Soviet Union. The NSA is used primarily for making essential safety improvements to older-generation, Soviet-built reactors and to help Ukraine cope with the aftermath of Chernobyl. As of October 2002, pledges to the NSA totalled €273 million.

The Bank has continued to administer the US$768-million Chernobyl Shelter Fund for securing the sarcophagus around the Unit IV reactor in Ukraine (which was destroyed by nuclear accident). The G-7 nations, the EU and other countries have pledged US$716 million, of which Canada has pledged US$33 million.

Three International Decommissioning Support Funds created in 2000 are now operational. They were put in place to assist with the decommissioning of potentially unsafe nuclear reactors in Lithuania (Ignalina Units 1 and 2), the Slovak Republic (Bohunice VI Units 1 and 2) and Bulgaria (Kozluduy Units 1–4).

Significant progress was not made during 2002 regarding negotiations on an EBRD loan of US$215 million approved in principle to help Ukraine's nuclear operator for the completion of, and safety upgrades to, the Khmelnitsky Unit 2 and Rovno Unit 4 (K2R4) nuclear power plants. EBRD financing was conditional on the permanent closure of the older Chernobyl 3 reactor, which occurred on December 15, 2000, as well as several other financing conditions. By November 2001 Ukraine had met all the required conditions and the loan was scheduled to go before the EBRD Board of Directors for final approval on November 29, 2001. On November 28 Ukraine unexpectedly indicated that it wanted a last-minute renegotiation of some of the loan conditions. As a result, no decision was taken and any loan agreement now requires a full review of all terms and conditions. Detailed technical discussions between the EBRD and Ukraine have taken place since that time but a new agreement has not been reached.

Addressing Corruption and Poor Governance

The transition countries, like most emerging economies, face significant challenges in improving transparency and governance. As required by its statutes (Article 1 of the Agreement Establishing the European Bank for Reconstruction and Development), the Bank reviews on an annual basis each country's progress towards multi-party democracy and pluralism. These principles—which Canada fully supports and encourages—contribute to transparency in public policy making and act as a check on corruption.

From this standpoint, the domestic policies of both Turkmenistan and Belarus were of particular concern in 2002 as they did not meet the requirements for normal Bank engagement as specified in Article 1 of the Bank's Articles of Agreement. As a result, the Bank included alternative lower lending scenarios in the 2002 country strategies for these countries. These scenarios linked the level and nature of the Bank's involvement to the extent of improvement in the economic and political situation. Without improvement in this area, these two countries risk continued exclusion from direct EBRD involvement with the state sector.

To a large degree, the EBRD seeks to enhance good governance and transparency in its countries of operations through the projects it undertakes. Equity investments have been an important tool in this regard. The Bank's participation on the boards of directors of companies in which it invests has been instrumental in improving the transparency of their accounting and business practices and their respect for minority shareholder rights. It is hoped that the success of these companies will demonstrate the importance of applying similar practices more broadly in the region. In addition, all Bank business partners are examined to ensure they meet the highest standards of business practice. The Bank now routinely seeks the services of forensic accountants and specialized firms to perform integrity checks on companies in which it might invest and their management and shareholders. For those doing business with the EBRD, the EBRD's public procurement rules underline the standards of ethics and conduct required during the procurement and execution of EBRD-financed projects.

The Bank's work in the area of legal transition also supports these goals. Under its Legal Transition Programme, the Bank has worked to improve the legal environment in its countries of operations by advancing legal reform in six areas: bankruptcy, company law/corporate governance, concessions, financial market regulation, secured transactions and telecommunications. In addition, the Bank has participated in international standard-setting efforts including the World Bank's Insolvency Initiative, which seeks to develop international principles of bankruptcy, and the Financial Stability Forum's efforts to coordinate the development and implementation of international financial standards. The Bank also initiated a project with the Russian Federal Commission for the Securities Market to develop a Corporate Governance Code and helped the CIS Inter-Parliamentary Assembly draft a model securities law. To promote transparency the EBRD publishes an annual survey of the extensiveness and effectiveness of various commercial laws in the region in its legal journal, *Law in Transition*.

Enhancing Institutional Transparency, Accountability and Governance

The EBRD's recently modernized Public Information Policy is based on the presumption that information about Bank activities should be made public in the absence of a compelling reason for confidentiality. The following documents are available to the public, with commercially sensitive information deleted as required: draft sectoral policies (for public comment); final sectoral policies; Board-approved country strategies following consultation with the country concerned; summaries of medium- and long-term operational strategies; executive summaries of environmental impact assessments for public and private sector projects; and reports on public sector projects (on a request basis). The Bank's policy requires management to report annually to the Board on the implementation of the Public Information Policy. These findings are made available on the Bank's Web site.

In 2002, in the context of its biannual Public Information Policy Review, the Bank proposed that the public be invited to submit comments for consideration in the preparation of country strategies. It was also proposed that country strategies be translated into the national language of the country in question. Decisions on these initiatives will be taken in 2003. Other transparency-enhancing initiatives proposed in 2002 included the preparation of an annual environmental report containing data on the Bank's environmental spending and achievements and on greenhouse gas emissions in countries of operations, and the release of Environmental Impact Assessments in local languages.

An Independent Recourse Mechanism, which would resolve complaints concerning Bank compliance with its own policies, was also proposed. This is in addition to the Manager of Outreach/NGO Relations, who serves as a point of contact between the Bank and the NGO (non-governmental organization) community. The EBRD usually evaluates its projects within two years after full disbursement to assess the extent to which the projects have met their objectives. In 2002 more than three-quarters of the Bank's evaluated projects received an "Excellent-Satisfactory" rating for "transition impact."

During the year the EBRD established a hotline to report allegations of fraud, corruption and other misconduct in the Bank's activities and projects.

As concern within the international community related to terrorism continued into 2002, the Bank adhered to internationally coordinated controls on the illegal use of funds. This included extensive checks on the integrity of potential clients and monitoring levels of corruption in countries of operations.

Canada welcomed these policy initiatives. In all international financial institutions (IFIs) in which it is a member, Canada has been at the forefront of efforts to enhance transparency and accountability.

Encouraging Partnerships

The EBRD is required by its founding agreement to involve outside sources of financing in its operations. By virtue of its guarantees to a project, the Bank can play a key role in attracting co-financiers that might not otherwise be willing to invest in the region. Co-financing has the benefit of increasing a country's access to international capital markets, promoting foreign direct investment and allowing appropriate risk sharing. The EBRD's main co-financing partners are commercial banks, government agencies, export credit agencies and other IFIs. In 2002 the EBRD worked with 41 commercial banks from 16 countries on 30 projects, for total co-financing of nearly €900 million.

The EBRD also works with donor countries to provide financing for institution building and technical cooperation. Such funding has played a significant role in promoting transition. Where possible, the EBRD also works with other IFIs in order to extend the impact of the Bank's financing and to benefit from complementarities with the other institutions. In 2002 the EBRD worked with other IFIs on 25 projects involving €612 million in co-financing. Key partners for the EBRD included the World Bank, the Asian Development Bank, the European Investment Bank and the International Finance Corporation.

Canada has encouraged this cooperation and coordination among multilateral development banks and is pleased with the efforts of the EBRD to work more closely with its sister institutions.

Human Resources/Changes in Senior Management

At end December 2002 the EBRD had regular staff of 907 at its Headquarters, down from 913 in 2001. Locally hired staff in the Bank's Resident Offices totalled 237, down from 247 in 2001. There are approximately twice as many male professional staff as female professional staff.

Johnny Åkerholm, a Finnish national, was appointed Secretary General in March 2003, replacing Antonio Maria Costa. In December Joachim Jahnke retired as Vice President, Evaluation, Operational and Environmental Support. He will be replaced in early 2003 by Fabrizio Saccomanni.

Canadian Priorities in 2002

Canada is a strong supporter of the Bank's medium-term operational priorities, which are premised on: the central importance of creating and strengthening those institutions that ensure markets work well; the key role that small businesses can play in creating dynamic, competitive and more equitable economies; and the relevance to the transition process of the Bank's mandate to support countries committed to and applying the principles of multi-party democracy and pluralism.

To achieve these priorities, Canada supports the Bank's focus on:

- promoting transparency and accountability in public sector management;
- developing sound financial sectors linked to the needs of enterprises and households;
- providing leadership for the development of micro lending and SMEs;
- developing market-based and commercially oriented infrastructure;
- demonstrating, through selected examples, effective approaches to restructuring viable large enterprises;
- taking an active approach in its equity investments to improve corporate governance;
- engaging governments in policy dialogue to strengthen institutions and improve the investment climate;
- taking a regional approach where appropriate; and
- promoting sustainable development and environmental due diligence.

The EBRD is the only multilateral financial institution that has an explicit requirement that its members be committed to and apply principles of multi-party democracy and pluralism. Canada fully supports this requirement and believes it is appropriate for the Bank to limit its participation in those countries not living up to the principles embodied in Article 1.

Promoting a multilateral rules-based trading system is also a key Canadian priority, and many of the Bank's activities work to support the integration of the transition countries into the world trading system.

The EBRD is committed to working closely and cooperatively with other IFIs and donors in the region. Canada strongly supports this approach. Coordination with other IFIs and donors is an important determinant of the EBRD's effectiveness in promoting the transition to a market economy. Further, the role of other IFIs in addressing poverty directly can complement the EBRD's work in the region.

Managing Canada's Interests

Role of Governors—The highest authority in the Bank is the Board of Governors. A Governor and an Alternate Governor represent each member country. The Honourable John Manley, Deputy Prime Minister and Minister of Finance, is the Canadian Governor and Mr. Gaëtan Lavertu, Deputy Minister of Foreign Affairs, is the Alternate Governor.

Role of the Board of Directors—The Board of Directors, which is responsible for the general operations of the Bank, is composed of 23 members, of which 4 are non-European members. Canada is the third largest non-European shareholder, after the United States and Japan, and by virtue of its share has the right to elect its own Director. Canada also represents Morocco at the Bank. The Canadian Director is Scott Clark. The Minister (Economic/Commercial) at the Canadian High Commission in London, David Plunkett, is the non-resident Alternate Director and represents Canada in the absence of the Canadian Director.

Role of Canadian Government Departments—Within the Canadian government, responsibility for oversight of the EBRD's activities resides with the International Policy and Institutions Division of the Department of Finance. In consultation with the Department of Foreign Affairs and International Trade and the Canadian International Development Agency (CIDA), the Department of Finance regularly reviews the Bank's policy papers and proposed country strategies and provides advice to the Canadian Director.

Functions of the Canadian Director—In addition to participating in regular Board meetings, the Canadian Director was, until September 2002, a member of the Financial and Operations Policies Committee, which reviews financial policies, including the Bank's borrowing policy, general policies relating to operations, and procedures and reporting requirements. In September 2002 the Canadian Director joined the Audit Committee, which reviews items such as the budget, institutional performance reports and other issues affecting the financial performance of the Bank.

Positions Taken in 2002—The Canadian Director has frequently spoken to the Board on the importance of the Bank's charter requirement that member countries be committed to market reform and multi-party democracy. In 2002 Canada's Director spoke on the need to address issues related to graduation from Bank operations for those countries that will be acceding to the EU in the near term.

To ensure EBRD operations are additional (i.e. do not replace private sector investment) and contribute to the transition process, Canada continued to advocate increased Bank efforts to find sound projects in countries that are in the early and intermediate stages of transition, respect the principles of multi-party democracy and are making efforts at reform. In our view, only by focusing on quality projects will the Bank contribute to advancing transition in these countries. In the advanced transition countries, Canada has underlined the need for Bank financing to be additional, as the Bank's Articles of Agreement state that it should not displace financing available from the private sector on reasonable terms. Therefore we have urged the Bank to be increasingly focused and strategic in the advanced transition countries, where private sector financial and capital markets are increasingly active.

Canada has also been a strong proponent of greater EBRD transparency and shareholder accountability, believing that the Bank should be a model of behaviour for the region. Canada has also supported measures to strengthen internal governance at the Bank to ensure that all staff function at the highest standards of business integrity, as well as efforts to strengthen the budget process.

Canadian Staff at the EBRD—Canadians are well represented on EBRD staff. At the end of 2002 there were 23 Canadian professionals on the staff of the EBRD, representing 3.6 per cent of total professional positions, in line with Canada's 3.4-per-cent share of the institution's capital. It is noteworthy that a Canadian is Director of Communications and that a Canadian also heads the Procurement and Purchasing Department.

Canada's Voting Record

Canada and other shareholders typically raise concerns and questions about specific Bank operations before they get to the Board. As a result, decisions at the Board are generally taken by consensus. Directors may, however, abstain or vote against projects as determined by consultations with their constituencies. The Canadian Director abstained or voted against the folowing policies and projects in 2002:

- A €3.5-million capital increase in Unibanka, a commercial bank in the Slovak Republic, because of insufficient transition impact and additionality; a US$90-million loan to finance the Severstal-Arcelor joint venture in Russia, because of concerns with global overcapacity in the steel industry and with sound banking; and a US$25-million revolving facility for Daewoo Mangalia Heavy Industries, a ship-building company in Romania, because of concerns over sound banking and lack of transition impact.
- The Director for Canada voted against the Staff Compensation and Benefits Proposals for 2003 because of concerns that the Bank had not provided adequate justification for a 4.8-per-cent salary increase, which was in excess of inflation in the United Kingdom.

Canadian Commercial Interests

The EBRD offers a number of investment opportunities for Canadian businesses and financial institutions. A key task of the Canadian Office is to increase Canadian awareness of these investment opportunities, explain how the Bank's financing mechanisms work, and ensure that EBRD policies and procedures are followed in a transparent and fair manner.

To achieve these objectives, the Canadian Office provides EBRD market information and intelligence to Canadian firms and advises Canadian project sponsors on EBRD financing options. In addition, the office develops commercial co-financing opportunities with Export Development Canada and other Canadian financial institutions. Together with the Department of Foreign Affairs and International Trade and Industry Canada, the office also identifies EBRD procurement opportunities and, with CIDA, promotes Canadian technical cooperation activities and official co-financing with the EBRD.

In 2002 the EBRD's Board of Directors approved EBRD participation in one Canadian-sponsored transaction, for MobiFon in Romania. The aggregate size of this project is US$300 million, of which EBRD financial commitments are US$230 million. A description of the transaction is given in Annex 2. Additionally, the Board of Directors approved an equity increase in a Canadian-sponsored project in the Czech Republic (originally approved in 2000) to bring the Bank's shareholding to US$26.2 million from US$25 million, in TIW Czech N.V., a telecommunications provider owned by Telesystem International Wireless Inc. (Canada).

With respect to official co-financing and technical cooperation, in 2002 the EBRD committed approximately €2.1 million for projects in several countries of operations. Under the CIDA-EBRD Cooperation Fund for Southeastern Europe, Canada committed approximately €50,000 to finance the Macedonia portion of a regional civil aviation upgrading project. Through the Canadian Technical Cooperation Fund, Canada committed €1.82 million to finance projects in four countries of operations (Russia, Uzbekistan, Armenia and Lithuania) as well as two regional projects in a variety of sectors—municipal and environmental infrastructure, transport, energy, finance/business, community/social services, manufacturing and construction. In addition, through the TurnAround Management Programme, Canadian advisors were awarded contracts totalling €224,000 to assist with airport modernization in Russia and the retail sector in Ukraine. Looking forward, the EBRD hopes to increase the number of high-quality Canadian project sponsors with whom it invests to better align its official co-financing and technical cooperation needs with Canadian interests in the region, and to strengthen its partnership with Export Development Canada and other Canadian commercial co-financiers.

Promoting Canada's Interests

Members of the Canadian Office made a number of visits to Canada and the EBRD's countries of operations in 2002 to meet with business people, conduct seminars, speak at conferences and consult with government officials. This included the Conférence de Montréal, where the Canadian Director made a presentation on the role of the EBRD and opportunities for Canadian companies, and introduced representatives of Canadian companies to the Vice President, Finance of the EBRD. In addition, the Assistant to the Director accompanied the Prime Minister of Canada on the Canada-Russia business forum visit to Moscow.

Members of the Canadian Office met with approximately 80 Canadians during 2002, including business people, representatives of financial intermediaries, representatives from all levels of government, NGO representatives, consultants and academics.

Canada's commercial interests in the region were also promoted by:

- the Canadian Director and Assistant making presentations on opportunities for Canadian consulting companies to mobilize technical cooperation funds at the EBRD at federal and provincial government-sponsored forums in Toronto and Vancouver;
- the Canadian Office facilitating and sponsoring the EBRD's Environment Department's participation in Globe 2002, a premier environment conference held in Vancouver; and
- the Canadian Office facilitating EBRD participation at the Global Petroleum Show in Calgary, which targets Canadian oil and gas companies.

Challenges Ahead

In assisting its countries of operations over the second decade of transition, the EBRD will face significant challenges in expanding and managing its portfolio. In particular, the advanced transition countries, most notably those acceding to the EU, are increasingly able to obtain private sector financing. This suggests the need to focus the Bank's activities on those areas that represent real additionality and have sufficient transition impact to warrant the use of Bank resources.

In Russia, given the volatility of oil prices, priority will need to be given to promoting investment in a wide range of sectors, including the financial sector. In the early and intermediate transition economies, the challenge will be to find quality projects in a high-risk environment that is characterized by a lack of market-supporting institutions. The Bank must continue to work in close partnership with other international financial institutions. Expanded cooperation will also be necessary to develop high transition impact projects with explicit social and poverty alleviation benefits in order to strengthen the willingness of governments in some of the least advanced transition economies to move forward with politically difficult but essential reforms, particularly the restructuring or closure of large state-owned enterprises.

Good governance will continue to play a critical role in the future success of the region and, in this regard, the EBRD will need to find ways to conduct its business to promote its Article 1 commitment to the principles of multi-party democracy and pluralism. Attention to governance issues in Central Asia, in particular, which has intensified post September 11th, is expected to sharpen further as the Bank prepares to hold its Annual Meetings in Uzbekistan in May 2003. Canada will continue its vigorous support for Bank efforts to address issues related to the rule of law, human rights and democratic principles.

Good corporate governance will also figure prominently in the period ahead and the EBRD will need to continue to promote sound institutions, more efficient tax collection and improved legal and regulatory frameworks. It must ensure not only that appropriate legislation is developed, but also that it is properly implemented and enforced.

The first decade of transition has provided clear lessons for the future. Countries that have achieved more rapid and comprehensive reforms—particularly in liberalizing markets and trade, respecting government budget constraints and fostering the private sector by removing obstacles to the entry and exit of enterprises—have laid solid foundations for sustaining progress in reform. In these economies market-supporting institutions have tended to develop. These institutional frameworks—predictable fiscal and regulatory environments, secure property rights, an impartial judiciary and sound financial supervision and regulation—combined with appropriate macroeconomic policies, will lay the foundation for sustained rapid growth and increased access to international capital markets.

In contrast, in some countries in the Bank's region of operation, particularly those further east, progress in putting in place the institutions that underpin a market economy has been limited, and the process of liberalization and privatization is far from complete. As a result, economic growth remains vulnerable to external and internal shocks. In addition, the significant increase in poverty and inequality since the start of transition has eroded support for necessary reforms in many countries. Overcoming resistance to reform will be a challenge; it will require creating new employment opportunities and social fallback options for those displaced by structural change, and breaking the hold of powerful vested interests over the reform process.

Contacting the Office of the Director for Canada

The Canadian Director's office at the EBRD may be reached at:

Office of the Director for Canada and Morocco
European Bank for Reconstruction and Development
One Exchange Square, Room 8.15
London, EC2A 2JN
United Kingdom

Mr. C. Scott Clark, Director	Tel:	+44 20 7338 6457
Mr. David Plunkett, Alternate Director[1]	Tel:	+44 20 7338 6507
Ms. Julie Fujimura, Director's Assistant[2]	Tel:	+44 20 7338 6458
Ms. Sandy Ferguson, Director's Assistant[3]	Tel:	+44 20 7338 6509
Ms. Alicja Krivicky, Executive Secretary	Tel:	+44 20 7338 6507
	Fax:	+44 20 7338 6062
	Internet address:	krivicky@ebrd.com

[1] Resident at the Canadian High Commission in London.

[2] Responsible for policy matters.

[3] Responsible for business development and investor liaison.

For More Information on the EBRD

The Bank releases considerable information on its various activities. Bank publications include information guides (such as *Financing With the EBRD*), special reports (such as the *Annual Report* and *Transition Report*), country strategies and assorted fact sheets.

Information can also be obtained on the Bank's Web site:

http://www.ebrd.com/

Requests for information can be addressed to:

Publications Desk
European Bank for Reconstruction and Development
One Exchange Square
London, EC2A 2JN
United Kingdom
(Fax: +44 20 7338 7544)

Annex 1

The Bank's Financial Activities

The Bank's financial activities are divided into ordinary and special operations, depending on the source of funds. Ordinary operations are financed from the ordinary capital resources of the Bank, which comprise subscribed capital, market borrowings and income from loans and investments. Special operations are those financed by "special funds" for specially designated purposes that are typically outside the Bank's regular activities. Unlike other regional development banks, however, the EBRD does not operate a concessional or "soft" loan window.

Ordinary Capital Resources

At the end of 2002 the total authorized capital of the Bank was €20 billion. Canada has subscribed to 3.4 per cent—or €680 million (C$958 million)—of the Bank's authorized capital. Canadian contributions to the Bank's capital are made in US dollars (at a pre-determined euro/US$ exchange rate).

In 2002 Canada made its fifth purchase of shares under the first capital increase (which came into effect on April 3, 1997, and doubled the initial €10-billion capital base). Under the first capital increase 77.5 per cent of Canada's share is "callable," meaning that the Bank can request these resources in the unlikely event that it requires them to meet its financial obligations to bondholders; the balance, or 22.5 per cent, is "paid-in." Payments are being made in eight equal annual installments (40 per cent in cash and 60 per cent in non-interest-bearing demand notes encashed over five years). The table on the next page details Canadian payments to the Bank in US dollars.

Canada's contributions to the Bank's capital are non-budgetary expenditures because our shares in the Bank are considered an asset. Nonetheless, Canada's contributions to the Bank do increase the Government's borrowing requirements.

Canadian Payments to the EBRD

Year	Notes	Cash	Encashment of notes	Total cash outlay
		(in US dollars)		
1991	11,903,502	11,903,502	11,903,502	23,807,004
1992	11,903,502	11,903,502	3,967,834	15,871,336
1993	11,903,502	11,903,502	7,935,668	19,839,170
1994	11,903,502	11,903,502	11,903,502	23,807,004
1995	11,903,502	11,903,502	11,903,502	23,807,004
1996	–	–	7,935,668	7,935,668
1997	–	–	3,967,834	3,967,834
1998	7,287,198	4,858,132	1,457,440	6,315,572
1999	7,287,198	4,858,132	2,914,879	7,773,011
2000	7,287,198	4,858,132	4,372,319	9,230,451
2001	7,287,198	4,858,132	5,829,759	10,687,891
2002	7,287,198	4,858,132	7,287,198	12,145,331
Total	**95,953,500**	**83,808,170**	**81,379,105**	**165,187,276**

Market Borrowings

At the end of 2002 total outstanding debt was €13.4 billion with an average maturity of 8.7 years at an average cost of funds of LIBOR (London Inter-Bank Offered Rate) minus 33 basis points. Funds have been swapped into floating-rate instruments, primarily in US dollars, euros and Deutsche Marks.

Standard & Poor's has assigned the Bank an AAA long-term and A1+ short-term credit rating. Moody's Investors Service has similarly rated the EBRD long-term bonds AAA.

Special Funds

The EBRD administers a number of bilateral and multilateral technical assistance funds. Canada has contributed to the following special funds:

The Canadian Technical Cooperation Fund—The main purpose of this fund is to provide financing to hire Canadian consultants for EBRD projects. Canada has contributed C$12.65 million since the fund was established in 1992.

Chernobyl Shelter Fund—The main purpose of this fund is to secure the sarcophagus around the destroyed Unit IV nuclear reactor in Ukraine. The total estimated cost of this eight-year project is US$768 million, of which US$716 million has been pledged so far. Canada has pledged US$33 million, including US$0.8 million of bilateral assistance for ventilation stack repair.

Nuclear Safety Account (NSA)—This facility was established in 1993 to help finance the closure of the Chernobyl nuclear power plant and to improve safety conditions at nuclear power plants in countries of operations until the plants can be closed. The NSA complements other bilateral and multilateral

nuclear safety technical assistance and functions in parallel with multilateral efforts to achieve broader energy sector reform in the region. Canada has contributed C$19.5 million to the total fund of €273 million.

Russia Small Business Fund (RSBF)—The purpose of this fund is to establish a facility for small business finance and micro lending in various regions of Russia. The RSBF was established in 1993 as a pilot project and became permanent in 1995. Canada has contributed C$11.3 million towards the US$300-million fund.

CIDA-EBRD Cooperation Fund for Southeastern Europe (CFSEE)—In support of the EBRD's South Eastern Europe Action Plan, Canada has contributed C$12 million for technical cooperation and co-financing activities in Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FYR Macedonia, Romania and FR Yugoslavia. In 2002 Canada added a further C$4 million to the $6 million it had already made available to the EBRD through the CFSEE for technical cooperation and co-financing tied to Canadian consultants and suppliers. The remaining C$2 million has been provided to the EBRD for untied co-financing of critical investment projects under the Bank's Balkan Region Special Fund.

TurnAround Management Programme—The TurnAround Management Programme was established in 1993 to match senior industrial advisors from market-driven economies with chief executives of selected firms in the region. The objective is to provide industrial management know-how and develop business skills so that these companies can become competitive and profitable. Canada made a contribution of C$550,000 to this program to be used to hire Canadian advisors.

Ukraine Micro Finance Bank (MFB)—In 2000 Canada entered into a contribution agreement with the EBRD to provide C$1.25 million for the provision of technical assistance related to the development of the MFB. Over three years Canada is assisting the MFB to develop a branch network throughout Ukraine, with special attention being paid to Slavutych, the community where many former employees of the Chernobyl nuclear power plant reside. As a greenfield operation specializing in financial services for the micro and small enterprise sector, the MFB is also serving as a demonstration bank for the Ukrainian commercial banking sector to show the commercial viability of micro and small enterprise lending.

Technical assistance in support of the Ukraine Micro, Small and Medium-Sized Enterprises Line of Credit II—Between 1999 and 2004 Canada will provide C$3 million for technical assistance services by qualified Canadian organizations to Ukrainian commercial banks receiving loans under the EBRD's Ukraine Micro, Small and Medium-Sized Enterprises Line of Credit II for on-lending to micro, small and medium-sized enterprises. The technical assistance will include risk- and loan-evaluation training.

Annex 2

EBRD—Canadian-Sponsored Project Activity in 2002

Date of Board approval	Canadian company	Project country	Project name	Type of financing	Sector	EBRD commitment
July 2002	MobiFon S.A.	Romania	MobiFon Corporate Loan Facility	Senior loan	Telcom-informatics and media	US$230 million

Annex 3

Doing Business With the EBRD

General inquiries about working with the EBRD should be directed to the Office of the Director for Canada or to the Bank's Communications Department in London (tel: +44 20 7338 6096; fax: +44 20 7448 6690).

Canadian Project Sponsors: Canadian companies interested in potentially sponsoring a project with the EBRD are requested to direct initial inquiries either to Project Inquiries in London (tel: +44 20 7338 6282 or +44 20 7338 6252; fax: +44 20 7338 6102) or to the Bank's resident office in the country of operation. Summaries of EBRD private sector operations can be obtained on the Bank's Web site at http://www.ebrd.com/.

Canadian Suppliers of Goods and Works: The EBRD makes available information on all stages of public sector project development, from the point a project has been identified by the Bank through to its approval. Procurement opportunities and co-financing notices, as well as contract awards information, can be accessed on the Bank's Web site free of charge (see address above).

Canadian Consultants: The EBRD's Web site contains technical cooperation notifications and invitations for expressions of interest for consultancy services pertaining to both public and private sector projects. The EBRD also makes use of the World Bank's electronic Data on Consultants (DACON) registration system. Although it is not required for consultants to register with DACON to be eligible for EBRD assignments, it is nonetheless advisable as it is a useful marketing tool. Requests for DACON registration packages should be sent directly to:

DACON Information Centre
World Bank
1818 H Street
Washington, DC 20433 USA

Individual Canadians: The EBRD maintains a recruitment section on its Web site, which provides information on specific employment competitions at the Bank as they become available. In general, applications for employment for both permanent positions and summer jobs should be sent to:

Franco Furno, Director for Human Resources
Human Resources Management Department
European Bank for Reconstruction and Development
One Exchange Square
London, EC2A 2JN
United Kingdom

Annex 4

EBRD Membership as at December 31, 2002

	Share of the Bank's capital (%)
European Members	
Austria	2.28
Belgium	2.28
Cyprus	0.10
Denmark	1.20
Finland	1.25
France	8.52
Germany	8.52
Greece	0.65
Iceland	0.10
Ireland	0.30
Israel	0.65
Italy	8.52
Liechtenstein	0.02
Luxembourg	0.20
Malta	0.01
Netherlands	2.48
Norway	1.25
Portugal	0.42
Spain	3.40
Sweden	2.28
Switzerland	2.28
Turkey	1.15
United Kingdom	8.52
European Union	3.00
European Investment Bank	3.00
Non-European Members	
Australia	0.50
Canada	**3.40**
Egypt	0.10
Japan	8.52
Korea, Republic of	1.00
Mexico	0.15
Mongolia	0.01
Morocco	0.05
New Zealand	0.05
United States	10.00

	Share of the Bank's capital (%)
Countries of Operations	
Albania	0.10
Armenia	0.05
Azerbaijan	0.10
Belarus	0.20
Bosnia and Herzegovina	0.17
Bulgaria	0.79
Croatia	0.36
Czech Republic	0.85
Estonia	0.10
FR Yugoslavia	0.47
FYR Macedonia	0.07
Georgia	0.10
Hungary	0.79
Kazakhstan	0.23
Kyrgyzstan	0.10
Latvia	0.10
Lithuania	0.10
Moldova	0.10
Poland	1.28
Romania	0.48
Russia	4.00
Slovak Republic	0.43
Slovenia	0.21
Tajikistan	0.10
Turkmenistan	0.01
Ukraine	0.80
Uzbekistan	0.21

Report on Operations Under the European Bank for Reconstruction and Development Agreement Act

2003

Canada

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2003

Prepared by:
International Trade and Finance Branch
March 2004

Department of Finance Canada
Ministère des Finances Canada

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Introduction

The European Bank for Reconstruction and Development (referred to in this document as the EBRD or the Bank) was established in 1991. Its aims are to foster the transition towards open, market-oriented economies in Central and Southeastern Europe, as well as in the successor states of the former Soviet Union, and to promote private and entrepreneurial initiative in those countries that are committed to the fundamental principles of multi-party democracy, pluralism and a market economy (see Annex 3 for a list of the EBRD's 27 countries of operations).

The EBRD differs from other multilateral development banks in four ways. First, its overriding focus is the private sector and support for the transition from central planning to stable market economies. Its charter stipulates that not less than 60 per cent of its financing commitments should be directed either to private sector enterprises or to state-owned enterprises implementing a program to achieve private ownership and control. Second, it has a particular focus on the promotion of democratic institutions and human rights in its countries of operations. Third, while all multilateral development banks are committed to ensuring the environmental sustainability of their projects, the EBRD is the only such institution where this commitment is explicitly written into its Articles of Agreement. Fourth, the EBRD does not provide concessional financing.

The Bank seeks to help its 27 countries of operations to implement structural and sectoral economic reforms, taking into account the particular needs of countries at different stages in the transition process. In particular, its private sector activities focus mainly on enterprise restructuring, including the strengthening of financial institutions, and the development of infrastructure needed to support the private sector. The EBRD has 62 members: 60 countries, the European Union (EU) and the European Investment Bank (see Annex 3 for a list of members).

Canada is the eighth largest shareholder (tied with Spain), following the other Group of Eight (G-8) countries. Our formal participation is authorized under the European Bank for Reconstruction and Development Agreement Act, which was promulgated in February 1991. Article 7 of the Act states that:

> The Minister [of Finance] shall cause to be laid before each House of Parliament by March 31 of each year or, if that House is not then sitting, on any of the thirty days next thereafter that it is sitting, a report of operations for the previous calendar year, containing a general summary of all actions taken under the authority of this Act, including their sustainable development aspects within the meaning of Article 2 of the Agreement, and their human rights aspects.

This report responds to this requirement and reviews the activities and operations of the Bank for the year 2003.

BENEFITS OF MEMBERSHIP

As a major trading nation, Canada has a stake in global peace and stability, which the successful integration of Central and Southeastern Europe and the former Soviet Union into the world economy and global institutions helps to promote. By fostering continued political and economic reform in the region, the EBRD is contributing to its integration into the world economy and to its stability.

The Minister of Finance is a Governor of the Bank and appoints a Director to its 23-member Board. This representation allows Canada to have high-level influence on decisions taken by the EBRD on investments in the region and on policies to move countries through the transition process. The EBRD also provides trade opportunities for the Canadian private sector, supporting a diversification of international markets for Canadian businesses.

The EBRD

- fosters the transition of former centrally planned economies of Central and Southeastern Europe and the successor states of the former Soviet Union towards market-oriented economies;
- promotes private entrepreneurial initiative by targeting at least 60 per cent of its resources to private sector projects, with the balance in support of commercially viable state sector projects that promote private sector development;
- operates only in countries committed to applying the principles of multi-party democracy, pluralism and market economics;
- promotes environmentally sound and sustainable development; and
- operates on a self-financing basis.

Role and Mandate of the EBRD

The EBRD's operations to advance the transition to a market economy are guided by three principles: maximizing transition impact, additionality and sound banking. Financing is provided for projects that expand and improve markets, help to build the institutions necessary for underpinning a market economy, and demonstrate and promote market-oriented skills and sound business practices. EBRD financing must also be additional to other sources of financing and not displace them, further ensuring that the Bank contributes to the transition process. Finally, Bank projects must be sound from a banking perspective, thus demonstrating to private investors that the region offers attractive returns. Adherence to sound banking principles also helps to ensure the financial viability of the EBRD and hence its attractiveness as a co-investment partner for the private sector.

In promoting economic transition in its countries of operations, the Bank acts as a catalyst for increased flows of financing to the private sector. The capital requirements of these countries cannot be fully met by official multilateral or bilateral sources of financing, and many foreign private investors remain hesitant to invest in the region, particularly the central Asian republics. By providing an umbrella under which wider funding for private sector investment can be assembled, the EBRD plays a catalytic role in mobilizing capital. In 2003, for every euro the EBRD invested, it mobilized an additional 1.4 euros from the private sector and other multilateral and bilateral agencies.[1] Commercial co-financing mobilized by the EBRD reached a record volume of 2.6 billion euros in 2003, up 30 per cent from the previous high in 2001.

The Bank's projects serve a dual purpose. They are intended not only to directly support the transition from a command to a market economy in countries of operations, but also to create a demonstration effect to attract foreign and domestic investors. Like the World Bank Group's International Finance Corporation, the Bank is required to operate on a strictly commercial basis and to attract companies through financially viable projects, not through subsidies.

Key Economic Developments in 2003

Most of the transition economies experienced economic growth in 2003, showing considerable resilience in the face of sometimes difficult external conditions. Most countries in the region continued to perform well in comparison with other emerging markets. The exception continues to be the poorer countries in the Commonwealth of Independent States (CIS),[2] where the reform process continues to lag and uncertain climates continue to discourage domestic and foreign investment. The process of transition to market-based economies continued to advance in most of the EBRD's countries of operations. The results of the Bank's annual exercise in assessing key transition indicators are summarized in the table on the next page.

[1] On December 31, 2003, one euro purchased 1.6279 Canadian dollars.

[2] The CIS includes Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan.

Progress in Transition in EBRD Countries of Operations

			Enterprises			Market and trade			Financial institutions		Infrastructure
Countries	Population (millions, mid-2001)	Private sector share of GDP in %, mid-2001 (EBRD estimate)	Large-scale privatization	Small-scale privatization	Governance and enterprise restructuring	Price liberalization	Trade and foreign exchange system	Competition policy	Banking reform and interest rate liberalization	Securities markets and non-bank financial institutions	Infrastructure reform
Albania	3.4	75	2+	4	2	4-	4+	2-	2+	2-	2
Armenia	3.0	70	3+	4-	2+	4+	4+	2	2+	2	2+
Azerbaijan	8.1	60	2	4-	2+	4	4-	2	2+	2-	2-
Belarus	10.0	25	1	2+	1	3-	2+	2	2-	2	1+
Bosnia and Herzegovina	4.3	50	2+	3	2	4	4-	1	2+	2-	2+
Bulgaria	8.1	75	4-	4-	3-	4+	4+	2+	3+	2+	3-
Croatia	4.6	60	3+	4+	3-	4	4+	2+	4-	3-	3-
Czech Republic	10.3	80	4	4+	3+	4+	4+	3	4-	3	3
Estonia	1.4	80	4	4+	3+	4	4+	3-	4-	3+	3+
FYR Macedonia	2.0	60	3	4	2+	4	4+	2	3	2-	2
Georgia	5.4	65	3+	4	2	4+	4+	2	2+	2-	2+
Hungary	10.0	80	4	4+	3+	4+	4+	3	4	4-	4-
Kazakhstan	14.9	65	3	4	2	4	3+	2	3	2+	2+
Kyrgyzstan	4.7	65	3	4	2	4+	4+	2	2+	2	1+
Latvia	2.4	70	3+	4+	3	4+	4+	3-	4-	3	3-
Lithuania	3.7	75	4-	4+	3	4+	4+	3	3	3	3-
Moldova	4.3	50	3	3+	2-	4-	4+	2	2+	2	2
Poland	38.7	75	3+	4+	3+	4+	4+	3	3+	4-	3+
Romania	22.3	65	3+	4-	2	4+	4	2+	3-	2	3
Russia	145.4	70	3+	4	2+	4	3+	2+	2	3-	2+
Serbia and Montenegro	8.6	45	2+	3	2	4	3+	1	2+	2	2
Slovak Republic	5.4	80	4	4+	3	4+	4+	3	3+	3-	2+
Slovenia	2.0	65	3	4+	3	4	4+	3-	3+	3-	3
Tajikistan	6.2	50	2+	4-	2-	4-	3+	2-	2-	1	1+
Turkmenistan	5.4	25	1	2	1	3-	1	1	1	1	1
Ukraine	49.3	65	3	4	2	4	3	2+	2+	2	2
Uzbekistan	25.0	45	3-	3	2-	3-	2-	2-	2-	2	2-

Note: The classification of transition indicators uses a scale from 1 to 4, where 1 implies little or no progress with reform and 4 implies a market economy. A rating of 4+ indicates the country has achieved standards and performance typical of advanced industrial economies.

Source: EBRD, 2003 *Transition Report*.

Russia

Russia's economic growth is estimated to have increased by 7.3 per cent in 2003, up from 4.7 per cent in 2002. This stronger growth is largely the result of higher oil prices and an increase in oil production. Buoyant exports have kept the government budget in surplus (1.7 per cent of gross domestic product [GDP] in 2003), despite fiscal slippage in the midst of the election cycle (parliamentary elections were held in December 2003 and presidential elections are scheduled for March 2004). The ruble appreciated by over 9 per cent against the US dollar in 2003, despite active intervention by the central bank. Foreign exchange reserves increased by US$30 billion over the year, reaching a historic high of US$77.8 billion in December (or the equivalent of 18.3 per cent of GDP). The large accumulation of foreign reserves, however, hampered efforts to reduce inflation within the 10–12 per cent target range for 2003.

Economic growth since the 1998 financial crisis has been mainly driven by temporary factors such as the gain in competitiveness from the post-crisis real depreciation of the ruble and the upturn in oil prices. The benefits of these factors, however, are beginning to dissipate.

In order to promote more sustainable growth, Russia would need to diversify its economy by implementing reforms aimed at attracting investment in the non-energy sector and at improving the investment climate more generally. Substantial progress was made in implementing structural reforms in 2001 and 2002, but further progress slowed during the 2003–04 election cycle. Nonetheless, considerable progress has been achieved recently in improving productivity and strengthening corporate governance, and this has put the economy on a stronger footing. The main challenge ahead is to ensure that key structural reforms in the banking and corporate sectors are implemented.

Other CIS Countries

Other oil-exporting CIS countries also recorded rapid economic growth in 2003. This strong growth largely reflected oil windfalls and rising fixed investment in resource-based sectors. Kazakhstan recorded the strongest economic growth in the CIS in 2003, with real GDP estimated to have expanded by 9.2 per cent, down only marginally from the 9.5-per-cent rate in 2002. Azerbaijan's economy also maintained strong growth momentum, mainly due to a continuing investment boom in the oil and gas-related sectors. This resource-driven expansion, however, has only had a limited impact on the efforts on increasing employment and reducing poverty. As is the case in Russia, these countries face the challenge of diversifying their economic base away from the natural resource sector and managing the complications that can arise from large and volatile foreign exchange inflows.

Among the remaining CIS countries, which are less well endowed with natural resources, Ukraine is estimated to have recorded real GDP growth of 9.3 per cent in 2003, up substantially from the 4.8-per-cent level recorded in 2002. This stronger growth is largely the result of more favourable world

market conditions for the country's principal exports—steel and chemicals. More favourable economic conditions in 2003 provided the government with some room to reduce public debt and to increase foreign exchange reserves.

The poorest CIS countries (Armenia, Georgia, Moldova, Kyrgyzstan, Tajikistan and Uzbekistan) have achieved only modest economic growth over the past few years, with Armenia showing the best progress in the transition process. Per capita income still remains very low in all of these countries relative to other CIS countries. Poverty is widespread and these countries are increasingly reliant on concessional loan and grant financing from multilateral and bilateral donors. Reforms must urgently address the chronically poor investment climates and weak institutions if these countries are to enjoy stronger growth over the medium and longer term.

Central Europe

The economies of Central Europe[3] again showed considerable resilience in 2003, despite weakness in much of the global economy and poor growth in the EU. The economies of the Central European and Baltic countries are anticipated to have increased by an average of 2.5 per cent in 2003. The Baltic States continued to register the strongest growth, with GDP growth in Latvia reaching 7.2 per cent. A long-overdue resurgence in the Polish economy, where growth is estimated to be up by 3.7 per cent, is also boosting the average growth rate in the region. Poland's stronger economic growth can be attributed mainly to a significant easing of fiscal and monetary policy.

Large fiscal and current account imbalances have characterized Poland, Hungary, and the Czech and Slovak republics for the past few years, and foreign direct investment is beginning to decline. Consolidated general government deficits in these countries have exceeded 4 per cent of GDP over the past two years. In addition, much of the recent fiscal expansion has resulted from discretionary spending. Fiscal problems have had an impact on the exchange rate of the Hungarian forint, which fell to a historic low in December 2003. The Hungarian finance minister was forced to resign in January 2004, when the 2003 fiscal deficit was reported. The deficit, at 5.6 per cent of GDP, was higher than forecast.

Once the eight accession countries join the EU in May 2004, however, addressing these fiscal problems will need to be a high priority. Under the EU's Stability and Growth Pact, these countries will have to reduce their deficits to the Pact's 3-per-cent deficit/GDP maximum. At the same time, however, many of these countries will face pressures to fund various programs to raise internal standards to EU levels.

[3] Includes the Czech Republic, Hungary, Poland, the Slovak Republic, Slovenia and the three Baltic States (Estonia, Latvia and Lithuania).

Accession to the European Union

Accession to the EU has been an important factor underlying economic and political reform efforts in Central Europe. At the Copenhagen Summit in December 2002, the EU reached agreement on a timetable for final accession for the first wave of candidate countries. The Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic and Slovenia will become full members of the EU in May 2004. At the same time, a roadmap was articulated for the accession of Bulgaria and Romania, which is expected in 2007.

The EBRD, European Commission and World Bank have signed a memorandum of understanding (MOU) setting out the basic principles for collaboration in supporting projects that will assist all accession countries in meeting the requirements of the EU. In particular, the accession countries face specific requirements for investment in infrastructure to meet the requirements of the EU's *acquis communautaire*, or inventory of EU laws and standards. The EBRD actively supports projects where its mandate and EU accession requirements overlap. The imminent accession of the first wave of candidate countries has raised important issues concerning the operationalization of the interagency MOU and its interaction with the graduation policies of the World Bank and EBRD.

The EU has also offered the prospect of eventual EU membership for the countries of Southeastern Europe through the Stabilisation and Association Process. Under this process, the EU has started to negotiate agreements with democratic, reform-minded countries in the region. These offer the prospect of better trade access, increased assistance for education and institution building, cooperation in the areas of justice and home affairs, formal political relations with the EU and, one day, membership in the EU. It is hoped that the prospect of EU membership will spur reform efforts in Southeastern Europe as it has done in Central Europe.

Southeastern Europe

Recent political and economic stability, fostered by increasing cooperation among Southeastern European countries and closer ties between them and the EU, has helped the region increase economic growth rates over the past few years.[4] In 2003, GDP in the region increased by an estimated 3.9 per cent, down slightly from the 4.5-per-cent level achieved in 2002. Within the region, growth in Albania has been strongest, with GDP estimated to have grown by 6 per cent in 2003. Growth in the two EU accession candidates (for entry in 2007), Bulgaria and Romania, is estimated to have achieved 4.5 per cent and 4.9 per cent respectively in 2003. FYR Macedonia experienced a substantial increase in growth in 2003, following a contraction in GDP that coincided with a flare-up in inter-ethnic conflict in 2001. Although economic performance is improving in the region, GDP per capita still lags considerably behind the countries of Central Europe. Even in a relatively advanced country such as Bulgaria, which has been spared the ethnic tensions evident elsewhere in the region, GDP per capita remains less than one-third that of the Czech Republic or Hungary.

Southeastern European countries are continuing the difficult process of fiscal adjustment. Fiscal deficits, though still high in some countries in the region, have decreased substantially, with the average for the region estimated to have been 2.9 per cent of GDP in 2003. As in Central Europe, large fiscal deficits tend to be accompanied by large and persistent current account deficits, averaging 8.6 per cent of GDP for Southeastern Europe as a whole in 2003. The risks associated with these twin deficits are exacerbated by the region's large infrastructure expenditure requirements, falling aid flows and an onerous debt burden.

The region has only had very limited success in financing its high investment requirements through private capital flows. Except for Romania and Bulgaria, most capital inflows to the region have been in the form of official aid, which is now beginning to decline. Southeastern European countries will need to attract higher private flows in order to compensate for falling aid.

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[4] Southeastern Europe includes Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the Former Yugoslav Republic of Macedonia (FYR Macedonia), Romania, and Serbia and Montenegro, which became a member of the Bank in early 2001. Kosovo is a province of Serbia.

Canada's Cooperation With the EBRD in Southeastern Europe

In response to the Kosovo crisis in 1999, the EBRD developed the South Eastern Europe Action Plan (SEEAP), which seeks to promote investment and to assist in the economic recovery of the region. Eligible countries are Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FYR Macedonia, Romania, and Serbia and Montenegro.

Under the SEEAP, EBRD investments focus on developing commercial approaches to infrastructure (such as telecommunications, airports, and municipal and environmental infrastructure), micro, small and medium-sized enterprises, and the financial sector. These investments address the transition challenges facing the region: crumbling infrastructure, a weak industrial asset base, mostly small, fragile banks and pervasive problems of poor governance.

In 2000, Canada contributed $2 million to the Balkan Region Special Fund (BRSF) to support post-conflict reconstruction efforts in the Balkan region. In that same year, Canada created the Cooperation Fund for Southeastern Europe (CFSEE) in support of the SEEAP. As part of the first phase of this fund, the Canadian International Development Agency (CIDA) contributed $10 million. Between 2000 and 2002, $6.3 million of this fund was used to support six projects. In 2003, the remaining $3.7 million of the fund was used to support three new projects. These nine projects in total have targeted the transport sector, municipal infrastructure, local enterprise and capacity building.

In March 2003, CIDA launched a second $6-million phase of the CFSEE project, to build upon the results of Phase 1. This second phase will run until March 2005 and will adhere to the more focused programming approach outlined in CIDA's Strategy for the Balkan region. Funds will target countries CIDA has identified as priority countries—Bosnia and Herzegovina and Serbia and Montenegro—and will concentrate on priority sectors (financial institutions and municipal, environmental and regional infrastructure).

Canada's total contribution of $18 million to the CFSEE and BRSF is being used for technical assistance and co-financing related to project preparation and implementation, advisory services and capacity building. Our assistance has contributed to the efforts of both the EBRD and the international community in supporting the transition process and in promoting stability in the region.

2003 *Transition Report*

The *Transition Report* is an annual publication of the EBRD that charts the progress of transition from a centrally planned to a market economy in each of the Bank's 27 countries of operations. Given that eight EBRD countries of operations are on the threshold of EU membership, regional integration was chosen as the special theme of the 2003 report. The report notes that the process of the integration of transition countries into the world economy has not been uniform, with more rapid progress in the countries of Central Europe. The accession of most of these economies to the EU will have a significant impact on the structure of regional trade as well as on migration patterns—both legal and illegal. The countries of Southeastern Europe and the former Soviet Union are much less integrated into the world economy, and Central European accession raises a danger of further marginalization of some of these countries.

The 2003 *Transition Report* outlines three means of dealing with the problem of limited international integration of Southeastern European and former Soviet countries. First is the need to improve market access to EU markets. Second is the need for these countries to press ahead with institutional and structural reforms. The *Transition Report* recommends that greater EU market access should be granted in parallel with such reforms. Finally, the report suggests that there should be closer regional cooperation to complement the process of international integration. The report points to the EU's Stabilisation and Association Process with the countries of Southeastern Europe. In the case of the former Soviet countries, where trade is limited by obstructive domestic and regional trade policies as well as distance from other markets, more attention is needed to improving regional cooperation on trade and transit issues.

2003 Financial Results

2003 marked another strong year for EBRD financial performance. The institution earned a profit after provisions of €378.2 million. This compares very favourably with the €108.1 million figure recorded in 2002. The EBRD continued to see a reduction in its impaired assets (non-performing loans) in 2003. At December 31, 2003, the EBRD had 19 impaired loans totalling €125.2 million, compared with 23 such loans in 2002 totalling €204.5 million at the end of the year. The EBRD's general administrative expenses in 2003 were £132.8 million, compared to £142.0 million at the end of 2002. This performance reflected continuing budgetary discipline, effective cost controls, a proactive cost-recovery program and a renegotiation of its Headquarters building rental contract.

The EBRD approved 119 projects in 2003, up from 102 the previous year. These commitments totalled €3.7 billion, down slightly from €3.9 billion in 2002, but within the €3.5-billion to €3.9-billion target range of the Bank's medium-term operational strategy. Net cumulative commitments by the end of 2003 amounted to €22.7 billion. The level of disbursements, at €2.1 billion, was slightly lower than the €2.4 billion recorded in 2002. While the EBRD

reports operations in euros, many of its commitments and disbursements are made in US dollars. Therefore, the depreciation of the US dollar lowered the euro value of its operations in 2003. In addition to disbursements, EBRD guarantees increased by 31 per cent to €342 million at the end of 2003.

The increasing access of the advanced transition countries to private capital and financial markets and the continued poor investment climate in many early and intermediate transition countries continue to be a challenge for the Bank.[5] The Bank needs to continue to balance the requirement to follow sound banking principles with the need to provide transition assistance to countries where the investment climate is risky. The financial results for 2003 suggest that, so far, the Bank continues to achieve this balance.

Financial Highlights

- The Bank recorded €3.7 billion of new operations in 2003, a decrease of €200 million from 2002. Of this amount, 39 per cent was approved for early and intermediate transition economies in the former Soviet Union and Southeastern Europe. The remaining 61 per cent was roughly equally divided between Russia and the advanced transition economies of Central Europe and the Baltic States.
- While the institution reports its financial results in euros, the depreciation of the US dollar in 2003 reduced the euro value of EBRD operations, given that many of its operations (and especially those in CIS countries) are transacted in US dollars.
- Profits after provisions rose to €378.2 million, which compares favourably to the €108.2 million amount in 2002.
- Total provisions on banking assets were €1.1 billion at the end of 2003, compared to €1.2 billion at the end of December 2002.
- Gross disbursements, at €2.1 billion, were down slightly from 2002.
- The Bank mobilized €1.4 in additional financing for every euro that it invested in 2003, compared to €1.2 in 2002.
- The private sector share of annual business volume was 79 per cent, up significantly from the 71 per cent reported in 2002.
- Administrative expenses, denominated in pounds sterling (the currency in which most of the Bank's expenses accrue), were £132.8 million, continuing a 10-year trend of no real increases in approved budgets. Indeed, actual administrative expenses in 2003 were somewhat below the approved budget for the year.
- Reserves[1] at the end of 2003 were €989.6 million, up considerably from €661.1 million at the end of 2002.

[1] Reserves are Bank capital set aside to cover unexpected losses.

[5] Advanced transition countries include Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic and Slovenia. Early and intermediate transition countries include the balance of the EBRD's countries of operations, excluding Russia: Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, FYR Macedonia, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Romania, Serbia and Montenegro, Tajikistan, Turkmenistan, Ukraine and Uzbekistan. Russia is considered to be in a category of its own by the EBRD.

Institutional Developments

Private Sector Development

A key part of the EBRD's work with the private sector is its support of micro, small and medium-sized enterprises (SMEs), which are important engines for job creation and growth, and therefore poverty reduction. Canada is a strong proponent of the private sector work of the Bank, recognizing that a strong private sector is key for the successful transition to a market economy. Canada views a strong SME sector as one means of developing a "constituency for reform" in the transition economies that can act as a counterweight to powerful vested interests that benefit from weak state governance.

The Bank's strategy for the SME sector is founded on three pillars: financing, improving the investment climate through policy dialogue, and developing business support networks for SMEs. The strategy explicitly recognizes that the poor investment climate, and not just limited access to financing, is a major impediment to the development of the sector. The strategy emphasizes the need to identify and promote the removal of the main obstacles to SME growth, as well as to encourage the development of strong business associations.

About 79 per cent of the EBRD's annual business volume in 2003 was in the private sector, compared to 71 per cent in 2002 and 76 per cent in 2001, continuing the Bank's trend of exceeding its 60-per-cent minimum requirement by a wide margin. In 2003, the EBRD continued its strong focus on supporting credit lines for SMEs through financial intermediaries in its countries of operations. Since the Bank's first small business program was established in 1994, more than 450,000 loans worth more than US$3.0 billion have been disbursed to small and micro businesses. In 2003, the EBRD disbursed 197,802 loans for small and micro enterprises, totalling roughly US$1.2 billion.

Activities in the Financial Sector

Financial Sector Policy—The EBRD's financial sector policy takes a country-specific approach to financial sector development, focusing on the need to promote confidence and competition in an independent financial system. The EBRD seeks to strengthen confidence in the sector primarily by helping to improve local institutions' governance and business practices. It also tries to improve financial supervision and regulation, although its activities here are constrained by its investor role in the sector and potential concerns about conflict of interest. Nonetheless, as a reputable foreign investor in the sector, the EBRD offers important insights on supervisory and regulatory requirements, which it shares with other international financial institutions operating in the region and with governments. To address competition and independence, EBRD investments attempt to increase the diversity of institutions and services available (particularly to the private

sector and SMEs), facilitate foreign direct investment and strengthen the commercial orientation of state-owned financial institutions, particularly in preparation for privatization.

In 2003, the EBRD committed €1.2 billion in financing to financial sector operations. Financial sector operations represented about 32 per cent of the EBRD's entire business for 2003.

Banking Sector Activities—In 2003, the EBRD signed new loans valued at €333 million to the banking sector, and signed 10 equity transactions with local banks. In most cases where the EBRD holds an equity stake in a local financial institution, it is represented on the supervisory board of the institution, where it promotes management accountability, good corporate governance, sound banking practices, and appropriate environmental reviews and procedures. Participation in bank privatizations is a key factor behind equity investments in early and intermediate transition countries.

Non-Bank Financial Institutions—During 2003, the EBRD also stepped up its activities in the non-bank financial sector. New commitments of €83 million were made under the EBRD's micro and small enterprise program. The EBRD is one of the largest financial investors in this sector, with investments in local asset management and mutual fund companies becoming increasingly important as voluntary pension sectors in the Bank's countries of operations develop. By the end of 2003, the Bank had investments in the non-bank financial sector in most of the countries in the region, where necessary institutional and regulatory regimes had been or were in the process of being introduced. The EBRD also substantially expanded its financing of insurance companies, leasing companies and specialist mortgage lending institutions in 2003. New business totalled €295 million and was focused mainly in advanced transition countries.

Environment

Under its Articles of Agreement, the EBRD is explicitly committed to ensuring the environmental sustainability of all its projects. By investing in projects that reduce waste and pollution, the EBRD is playing an important role in improving environmental standards in borrowing countries. EBRD projects have focused on upgrading municipal wastewater plants and improving energy efficiency by upgrading power generation and distribution systems. The EBRD is also assisting borrowing countries to comply with EU environmental standards. It also works with commercial financial institutions in borrowing countries to increase the profile of environmental issues in their lending policies.

Following consultations in London, Russia, Hungary and Azerbaijan, the EBRD revised its Environmental Policy in 2003 to cover occupational and safety issues as well as core labour standards. The revisions also expand the EBRD's public consultation process and information disclosure with respect to project environmental impact assessments. The revised policy also requires, from 2004, that the Bank publish annual environmental reports.

Apart from the initiatives to specifically redress environmental weaknesses, many EBRD projects include environmental targets—for example, to reduce atmospheric emissions and industrial wastewater discharges and promote waste recovery, recycling and clean technologies.The EBRD contributes to international initiatives such as the "Environment for Europe" process, including the Environmental Action Plan for Central and Eastern Europe, the Danube River Basin Strategic Action Plan, and the Helsinki Commission and the Global Environment Facility, for which it is an executing agency. In 2003, the EBRD signed its first project in cooperation with the multi-donor Global Environment Facility (GEF). The project consisted of loans to participating banks in Slovenia for on-lending to private and public sector entities investing in projects that reduce water pollution flowing into the Slovene portion of the Danube River. The project is also the first private sector initiative in the GEF's portfolio of projects to reduce the pollution in international waters.

In 2003, three projects were approved for support under the recently created Northern Dimension Environmental Partnership (NDEP). The NDEP[6] provides donor funding to address severe environmental problems in northwest Russia, particularly in the areas of nuclear waste, water and wastewater treatment, and energy efficiency. Within the framework of its mandate, the EBRD supports relevant multilateral and regional agreements on the environment and sustainable development, including the Framework Convention on Climate Change and the measures agreed to in the Kyoto Protocol. Canada became an official contributor to the NDEP Support Fund at the end of 2003 and has committed €20 million. This made Canada, apart from Russia, the NDEP's sole non-European partner. Canada earmarked its contribution for the facility's "nuclear window," and this counts towards Canada's commitment to the G-8 Global Partnership program. To deal with nuclear waste, the NDEP provides full funding within an international cooperation framework designed to address the complex challenges of cleaning up the legacy of the Soviet navy's Northern Fleet.

In October 2003, together with the government of the Netherlands, the Bank launched a special EBRD Carbon Fund under the Joint Implementation (JI) mechanism of the Kyoto Protocol. This is one of the first such JI funds in Europe. Through this fund, the EBRD will purchase for the Netherlands greenhouse gas emission reductions (or carbon credits) earned through EBRD investments in renewable energy and energy efficiency projects in transition economies.

The EBRD applies environmental due diligence to all its investment and technical cooperation operations. Project sponsors are required by the Bank to undertake environmental impact assessments, analyses and audits that address potential environmental, health and safety, and socio-economic impacts of projects. Environmental impact assessments and analyses are

[6] NDEP members comprise Russia, the EBRD, the EU, the Nordic Investment Bank, Canada, Denmark, Finland, France, Germany, the Netherlands, Norway, Sweden, the UK.

conducted when potential impacts are significant. Environmental audits are performed post-approval. In some cases, both an audit and an assessment/analysis are performed. The EBRD also requires local financial intermediaries, through which it channels funds to micro, small and medium-sized enterprises, to adopt appropriate environmental policies and procedures.

Municipal and Environmental Infrastructure

EBRD investments in this sector focus on upgrading local facilities, such as municipal wastewater treatment plants, and on raising the service levels of municipal and local utility companies. Reducing costs and increasing the reliability of municipal services can stimulate the development of commercial and industrial enterprises. At the same time, greater access to clean water and sanitation services improves public health and increases public confidence in the transition process and ongoing reform efforts.

Over the last few years, the EBRD has increasingly relied on municipal, as opposed to sovereign, guarantees in this sector, providing local governments with important new financial opportunities and responsibilities. The EBRD's operations policy for municipal and environmental infrastructure emphasizes private sector involvement, the development of appropriate regulatory structures and improvements in energy efficiency.

In 2003, the EBRD provided financing of more than €188 million to projects designed to improve municipal infrastructure and promote energy efficiency. About half of these projects were in EU accession countries.

Energy Sector Investments

Most of the EBRD's countries of operations suffer from severe economic and environmental problems caused by polluting energy systems and inefficient energy pricing. Under its Energy Operations Policy, the Bank promotes energy efficiency through its operations. One of the policy's key objectives is to improve environmental performance, including meeting climate change objectives and supporting renewable forms of energy.

In 2003, the Bank approved one of its largest energy sector investments to date, totalling US$310 million for two related projects: the Baku-Tbilisi-Ceyhan (BTC) pipeline from Azerbaijan through Georgia to the Turkish coast and the Azeri-Chirag-Deepwater Gunashli (ACG) Phase 1 oilfield in the Caspian Sea offshore from Azerbaijan. The EBRD's decision to finance BTC and ACG reflects the importance of both projects in unlocking the economic potential of the resource-rich Caspian Basin. In addition to improving the prospects for sustainable economic development, EBRD (and International Finance Corporation) participation in the two projects brings increased transparency and improves business and environmental standards in Azerbaijan and Georgia.

The EBRD and Nuclear Safety

Through the Nuclear Safety Account (NSA), 15 donors, including Canada and other G-7 countries, have continued to work closely with the EBRD to improve nuclear safety in countries of Central and Southeastern Europe and in the former Soviet Union. The NSA is used primarily for making essential safety improvements to older-generation, Soviet-built reactors and to help Ukraine cope with the aftermath of Chernobyl. Total pledges to the NSA are €273 million.

The Bank has continued to administer the Chernobyl Shelter Fund for securing the sarcophagus around the Unit IV reactor in Ukraine (which was destroyed by nuclear accident). The G-7 nations, the EU and other countries have pledged US$716 million (of the original estimate of US$768 million), of which Canada has pledged US$33 million. In 2003, the conceptual design for the new shelter was completed and the overall budget revised to approximately US$1 billion. The Bank launched the first major tenders for the active construction phase of the Shelter Implementation Programme.

Three International Decommissioning Support Funds created in 2000 are now operational. They were put in place to assist with the decommissioning of potentially unsafe nuclear reactors in Lithuania (Ignalina Units 1 and 2), the Slovak Republic (Bohunice VI Units 1 and 2) and Bulgaria (Kozluduy Units 1–4).

Discussions between the EBRD and the government of Ukraine on financing for the completion of the Khmelnitsky Unit 2 and Rovno Unit 4 (K2R4) nuclear reactors continued during 2003. Since demanding a renegotiation of some of the loan conditions in November 2001, the government of Ukraine has largely completed the K2R4 reactors on its own. Ukraine is now suggesting that potential EBRD financing be focused on supporting safety upgrades alone. An independent assessment of the safety of Ukraine's completion work is expected to be concluded in early 2004, and it will inform the EBRD-Ukrainian financing discussions.

Addressing Corruption and Poor Governance

The transition countries, like most emerging economies, face significant challenges in improving transparency and governance. As required by its statutes (Article 1 of the Agreement Establishing the European Bank for Reconstruction and Development), the Bank reviews on an annual basis each country's progress towards multi-party democracy and pluralism. These principles—which Canada fully supports and encourages—contribute to transparency in public policy making and act as a check on corruption.

From this standpoint, the domestic policies of both Turkmenistan and Belarus were of particular concern as they are difficult to reconcile with the political and economic conditions set out in Article 1 of the Bank's Articles of Agreement. As a result, the Bank's lending programs in Turkmenistan and Belarus are restricted to the private sector. The Bank's country strategies for these two countries link the level and nature of the Bank's involvement to the extent of improvement in the political and economic situation. Without improvement in these areas, these two countries will continue to be excluded from direct EBRD investments in the state sector.

The human rights situation in Central Asia, and Uzbekistan in particular, was highlighted in 2003, when the EBRD Board of Governors held its Annual Meeting in Tashkent, Uzbekistan. Canada's acting Alternate Governor stressed the important link between human rights, the rule of law, economic reform and a climate conducive to attracting investment. In his remarks to the Annual Meeting, Bank President Jean Lemierre noted Uzbekistan's weak performance and stressed that the level of future Bank operations would depend on progress in improving human rights. Uzbekistan's progress towards the political and economic benchmarks set out by the Bank in its March 2003 country strategy for the country was monitored over the course of 2003, and an assessment of performance will be conducted in early 2004. Early indications would not lead us to expect a positive assessment.

To a large degree, the EBRD seeks to enhance good governance and transparency in its countries of operations through the projects it undertakes. Equity investments have been an important tool in this regard. The Bank's participation on the boards of directors of companies in which it invests has been instrumental in improving the transparency of their accounting and business practices and their respect for minority shareholder rights. It is hoped that the success of these companies will demonstrate the importance of applying similar practices more broadly in the region. In addition, all Bank business partners are examined to ensure they meet the highest standards of business practice. The Bank routinely seeks the services of forensic accountants and specialized firms to perform integrity checks on companies in which it might invest and on their management and shareholders. For those doing business with the EBRD, the EBRD's public procurement rules set the standards of ethics and conduct required during the procurement and execution of EBRD-financed projects.

The Bank's work in the area of legal transition also supports these goals. Under its Legal Transition Programme, the Bank has worked to improve the legal environment in its countries of operations by advancing legal reform in six areas: bankruptcy, company law/corporate governance, concessions, financial market regulation, secured transactions and telecommunications. In addition, the Bank has participated in international standard-setting efforts, including the World Bank's Insolvency Initiative, which seeks to develop international principles of bankruptcy, and the Financial Stability Forum's efforts to coordinate the development and implementation of international financial standards. The Bank also initiated a project with the Russian Federal Commission for the Securities Market to develop a Corporate Governance Code and helped the CIS Inter-Parliamentary Assembly draft a model securities law. To promote transparency the EBRD publishes an annual survey of the extensiveness and effectiveness of various commercial laws in the region in its legal journal, *Law in Transition*.

Enhancing Institutional Transparency, Accountability and Governance

The EBRD's Public Information Policy is based on the presumption that information about Bank activities should be made public in the absence of a compelling reason for confidentiality. The following documents are available to the public, with commercially sensitive information deleted as required: draft sectoral policies (for public comment); final sectoral policies; Board-approved country strategies following consultation with the country concerned; summaries of medium- and long-term operational strategies; executive summaries of environmental impact assessments for public and private sector projects; and reports on public sector projects (on a request basis). The Bank's policy requires management to report annually to the Board on the implementation of the Public Information Policy. These findings are made available on the Bank's Web site.

The Bank's Public Information Policy was reviewed and revised in 2003 to enhance transparency and to expand communications with stakeholders. As a result, the scope of information made available to the public will increase through the publication of certain project evaluation documents and the posting on the Bank's Web site of a schedule of forthcoming Board of Directors discussions. In addition, the process of public consultation will be strengthened. Under its revised policy, the Bank will post on its Web site an invitation (with an accompanying management note) for the public to provide input into the preparation of each new EBRD country strategy. Bank management has also committed to translate, on a pilot basis, future approved country strategies into local languages. The Bank will also translate the three documents that constitute the framework for its interaction with the public: the *Public Information Policy*, the *Environmental Policy* and the document which established an Independent Recourse Mechanism.

In April 2003, the Bank's Executive Board approved the creation of the Independent Recourse Mechanism, which has the mandate to resolve complaints concerning Bank compliance with its own policies. This is in addition to the Manager of Outreach/NGO Relations, who serves as a point of contact between the Bank and the NGO (non-governmental organization) community.

The EBRD's strengthened framework for interaction with the public has already yielded results, with the Bank's investments in the Baku-Tbilisi-Ceyhan pipeline and Azeri-Chirag-Deepwater Gunashli Phase 1 oilfield project being prime examples. Thanks to EBRD and International Finance Corporation (IFC) participation, the development of these projects involved an unprecedented level of consultation and transparency with NGOs and affected groups in the sponsoring countries. The EBRD and IFC held public meetings in Azerbaijan and Georgia to seek input from local communities.

To be accountable to its shareholders and its stakeholders, the EBRD evaluates its projects, usually within two years after full disbursement, to assess the extent to which the projects have met their objectives. In 2003, 83 per cent of the Bank's evaluated projects received an "Excellent-Satisfactory" rating for their "transition impact" potential.

As part of the international effort to combat the financing of terrorist activities, the Bank adheres to internationally coordinated controls on the illegal use of funds. This includes extensive checks on the integrity of potential clients and monitoring levels of corruption in countries of operations.

Canada has encouraged these policy initiatives. In all international financial institutions (IFIs) in which it is a member, Canada has been at the forefront of efforts to enhance transparency and accountability.

Encouraging Partnerships

The EBRD is required by its founding agreement to involve outside sources of financing in its operations. The Bank plays a key role in attracting co-financiers that might not otherwise be willing to invest in the region. Co-financing has the benefit of increasing a country's access to international capital markets, promoting foreign direct investment and allowing appropriate risk sharing. The EBRD's main co-financing partners are commercial banks, government agencies, export credit agencies and other IFIs. In 2003, the EBRD worked with 75 commercial banks on 61 projects, for total co-financing of €2.6 billion.

The EBRD also works with donor countries to provide financing for institution building and technical cooperation. Such funding has played a significant role in promoting transition. Where possible, the EBRD also works with other IFIs in order to extend the impact of the Bank's financing and to benefit from

complementarities with the other institutions. In 2003, the EBRD worked with other IFIs on projects involving €303 million in co-financing. Key partners for the EBRD included the World Bank, the Asian Development Bank, the European Investment Bank and the IFC.

Canada has encouraged this cooperation and coordination among multilateral development banks and is pleased with the efforts of the EBRD to work more closely with its sister institutions.

Human Resources

At end December 2003, the EBRD had regular staff of 946 at its Headquarters, down from 955 in 2002. Locally hired staff in the Bank's Resident Offices totalled 206, down from 218 in 2002. There are approximately twice as many male professional staff as female professional staff.

Canadian Priorities in 2003

Canada is a strong supporter of the Bank's medium-term operational priorities, which are premised on: the central importance of creating and strengthening those institutions that ensure markets work well; the key role that small businesses can play in creating dynamic, competitive and more equitable economies; and the relevance to the transition process of the Bank's mandate to support countries committed to and applying the principles of multi-party democracy and pluralism.

To achieve these priorities going forward, Canada continues to support the Bank's focus on:

- promoting transparency and accountability in public sector management;
- developing sound financial sectors linked to the needs of enterprises and households;
- providing leadership for the development of micro lending and SMEs;
- developing market-based and commercially oriented infrastructure;
- demonstrating, through selected examples, effective approaches to restructuring viable large enterprises;
- taking an active approach in its equity investments to improve corporate governance;
- engaging governments in policy dialogue to strengthen institutions and improve the investment climate;
- taking a regional approach where appropriate; and
- promoting sustainable development and environmental due diligence.

The EBRD is the only multilateral financial institution that has an explicit requirement that its members be committed to and apply principles of

multi-party democracy and pluralism. Canada fully supports this requirement and believes it is appropriate for the Bank to limit its participation in those countries not living up to the principles embodied in Article 1.

Promoting a multilateral rules-based trading system is also a key Canadian priority, and many of the Bank's activities work to support the integration of the transition countries into the world trading system.

The EBRD is committed to working closely and cooperatively with other IFIs and donors in the region. Canada strongly supports this approach. Coordination with other IFIs and donors is an important determinant of the EBRD's effectiveness in promoting the transition to a market economy. Further, the role of other IFIs in addressing poverty directly can complement the EBRD's work in the region.

Managing Canada's Interests

Role of Governors—The highest authority in the Bank is the Board of Governors. A Governor and an Alternate Governor represent each member country. The Honourable Ralph Goodale, Minister of Finance, is the Canadian Governor and Mr. Peter Harder, Deputy Minister of Foreign Affairs, is the Alternate Governor.

Role of the Board of Directors—The Board of Directors, which is responsible for the general operations of the Bank, is composed of 23 members, of which 4 are non-European members. Canada is the third largest non-European shareholder, after the United States and Japan, and by virtue of its share has the right to elect its own Director. Canada also represents Morocco at the Bank. The Canadian Director is Mr. Scott Clark. The Minister (Economic/Commercial) at the Canadian High Commission in London, Mr. David Plunkett, is the non-resident Alternate Director and represents Canada in the absence of the Canadian Director.

Role of Canadian Government Departments—Within the Canadian government, responsibility for oversight of the EBRD's activities resides with the International Policy and Institutions Division of the Department of Finance. In consultation with the Department of Foreign Affairs and International Trade and the Canadian International Development Agency (CIDA), the Department of Finance regularly reviews the Bank's policy papers and proposed country strategies and provides advice to the Canadian Director.

Functions of the Canadian Director—In addition to participating in regular Board meetings, the Canadian Director is a member of the Board of Directors' Audit Committee, which reviews the integrity and soundness of the Bank's policies and practices as well as the independence and performance of the Bank's internal controls. The Audit Committee also reviews reports of the Bank's External Auditor. The Canadian Director also participates in all meetings of the Board of Directors' Financial and Operations Policies Committee and the Budget and Administrative Affairs Committee.

Positions Taken in 2003—The Canadian Director has frequently spoken to the Board on the importance of the Bank's charter requirement that member countries be committed to market reform and multi-party democracy. In 2003, Canada's Director spoke on the need to address issues related to the disregard for human rights and democratic principles, especially in Uzbekistan. Canada's Director also spoke strongly on the need to rigorously apply the additionality test for projects in EU-accession countries and stressed the importance of the Bank's goal of shifting operations to the south and east to early and intermediate transition economies.

To ensure EBRD operations are additional (i.e. do not replace private sector investment) and contribute to the transition process, Canada continued to advocate increased Bank efforts to find sound projects in countries that are in the early and intermediate stages of transition, respect the principles of multi-party democracy and are making efforts at reform. In our view, only by focusing on quality projects will the Bank contribute to advancing transition in these countries. In the advanced transition countries, Canada has underlined the need for Bank financing to be additional, as the Bank's Articles of Agreement state that it should not displace financing available from the private sector on reasonable terms. Therefore we have urged the Bank to be increasingly focused and strategic in the advanced transition countries, where private sector financial and capital markets are increasingly active.

Canada has also been a strong proponent of greater EBRD transparency, accountability to shareholders and improved internal governance, believing that the Bank should be a model of behaviour for the region.

Canadian Staff at the EBRD—Canadians are well represented on EBRD staff. At the end of 2003, there were 24 Canadian professionals on the staff of the EBRD, representing 3.8 per cent of total professional positions, in line with Canada's 3.4-per-cent share of the institution's capital. It is noteworthy that a Canadian is Director of Communications and that a Canadian also heads the Procurement and Purchasing Department.

Canada's Voting Record

Canada and other shareholders typically raise concerns and questions about specific Bank operations before they get to the Board. As a result, decisions at the Board are generally taken by consensus. Directors may, however, abstain or vote against projects in consultation with their constituencies. The Canadian Director abstained or voted against the following policies and projects in 2003:

- A €20-million equity investment in Lafarge Slovenia, a cement company in Slovenia, on the grounds of a lack of additionality; a €2-million portage equity investment in Wienerberger, for the construction of a brick factory in Romania, because of a lack of additionality; a €60-million loan to Karelsky Okatysh in Russia because of concerns about the global overcapacity in the steel industry; two projects in Uzbekistan—a US$30.5-million loan to the City of Tashkent to finance the modernization of its heating system and a US$13-million loan to Bursel Tashkent Textile, for the construction and operation of a textile plant—given concerns about Uzbekistan's lack of progress in improving its human rights record.
- The Director for Canada abstained on proposed modifications to the Bank's Public Information Policy because of concerns that the changes did not go far enough to fulfill the Bank's commitment to transparency and accountability. While he supported improvements made to the policy, he questioned management's rationale for issuing "management notes" in lieu of draft country strategies as a basis for public consultations.

Canadian Commercial Interests

The EBRD offers a number of investment opportunities for Canadian businesses and financial institutions. The objectives of the Canadian Office are to increase Canadian awareness of these investment opportunities, explain how the Bank's financing mechanisms work, and ensure that EBRD policies and procedures are followed in a transparent and fair manner.

To achieve these objectives, the Canadian Office provides EBRD market information and intelligence to Canadian firms and advises Canadian project sponsors on EBRD financing options. In addition, the office develops commercial co-financing opportunities with Export Development Canada and other Canadian financial institutions. Together with the Department of Foreign Affairs and International Trade and Industry Canada, the office also identifies EBRD procurement opportunities and, with CIDA, promotes Canadian technical cooperation activities and official co-financing with the EBRD.

In 2003, 16 contracts that totalled €2.9 million were awarded to Canadian consultants across a variety of sectors and countries.

With respect to technical cooperation, in 2003 the EBRD committed approximately €3.1 million of Canadian technical cooperation funds for projects in several countries of operations. Canada signed a new agreement with the EBRD's TurnAround Management Programme to provide €1.5 million over five years to be used to hire Canadians to work as advisors to SMEs in EBRD countries of operations. Under this agreement, Canadian advisors were awarded contracts totalling €85,000 to assist with airport modernization in Serbia. Under the CIDA-EBRD Cooperation Fund for Southeastern Europe, Canada committed approximately €634,000 to finance a public consultation and awareness program in Serbia and Montenegro, a standard-setting for charges registers in the Balkans, the provision of an air transportation advisor, as well as the provision of support for the conduct of due diligence for an EBRD Direct Investment Facility that provides equity investments to SMEs in the region. Canada committed €1.1 million through its Canadian Technical Cooperation Fund. These commitments supported transportation and environmental projects in Russia as well as the financing of a Canadian bankruptcy specialist to work within the EBRD's Legal Transition Team. After January 1, 2004, Canada will no longer fund technical cooperation assignments in the Central European and Baltic countries that are acceding to the EU. In 2004, CIDA and the EBRD will work to align more closely their technical cooperation activities with CIDA programming priorities.

Looking forward, the EBRD hopes to increase the number of high-quality Canadian project sponsors with whom it invests to better align its official co-financing and technical cooperation needs with Canadian interests in the region, and to strengthen its partnership with Export Development Canada and other Canadian commercial co-financiers.

Promoting Canada's Interests

Members of the Canadian Office made a number of visits to Canada and the EBRD's countries of operations in 2003 to meet with business people, conduct seminars, speak at conferences and consult with government officials. A highlight for the year was the September investor outreach visit to Toronto, Montréal and Calgary, where the Canadian Director and the First Vice President for Banking met with representatives of the Canadian business and investment communities to explain the role of the EBRD and showcase opportunities for Canadian companies.

The following events in 2003 supported by the Canadian Director's office also promoted Canada's commercial interests:

- The Director, Advisor and representatives from the Bank's Infrastructure and Commercial Co-financing Units travelled to Ottawa, Winnipeg, Calgary and Vancouver in June to meet with Canadian consultants and officials on opportunities to mobilize technical cooperation funds at the EBRD.
- The EBRD's Deputy Chief Economist travelled in December to Toronto and Ottawa to present to business and government officials the key findings of the Bank's 2003 *Transition Report* on developments in the business and economic environments of the Bank's countries of operations.
- The Director and Advisor met in December with representatives of Canadian companies at the Paris Pollutec 2004 conference and trade show to explain how to do business with the EBRD.
- Officials from the Canadian Director's office participated with representatives of the EBRD's Co-financing and Trade Facilitation programs in Export Development Canada's Programme on Financing Trade and Investment in Russia, the CIS and the Balkans, which was held in Toronto and Ottawa in December and targeted to the Canadian banking and export communities.

Members of the Canadian Office met with approximately 90 Canadians in 2003, including business people, representatives of financial intermediaries, representatives from all levels of government, NGO representatives, consultants and academics.

Challenges Ahead

In assisting its countries of operations over the second decade of transition, the EBRD will face significant challenges in expanding and managing its portfolio. In particular, the advanced transition countries, most notably those acceding to the EU, are increasingly able to obtain private sector financing. This suggests the need to focus the Bank's activities on those areas that represent real additionality and have sufficient transition impact to warrant the use of Bank resources.

In Russia, given the volatility of oil prices, priority will need to be given to promoting investment in a wide range of sectors, including the financial sector. In the early and intermediate transition economies, the challenge will be to find quality projects in a high-risk environment that is characterized by a lack of market-supporting institutions. Given that the Bank's focus will be shifting more to the south and east, the Bank will be reviewing how it operates in early and intermediate transition countries, with a view to increasing both the effectiveness and the volume of its activities in these countries. The Bank must continue to work in close partnership with other international financial institutions. Expanded cooperation will also be necessary to develop high-transition impact projects with explicit social and poverty alleviation benefits in order to strengthen the willingness of governments in some of the least advanced transition economies to move forward with politically difficult but essential reforms, particularly the restructuring or closure of large state-owned enterprises.

The transition experience of the Bank provides clear lessons for the future. Countries that have achieved more rapid and comprehensive reforms—particularly in liberalizing markets and trade, respecting government budget constraints, fostering the private sector by removing obstacles to the entry and exit of enterprises, and promoting democratic reforms—have laid solid foundations for sustaining progress in reform. Transition is deepest in those countries that have made progress on economic and democratic reforms. In these economies, market-supporting institutions have tended to develop. These institutional frameworks—predictable fiscal and regulatory environments, secure property rights, an impartial judiciary and sound financial supervision and regulation—combined with appropriate macroeconomic policies, will lay the foundation for sustained rapid growth and increased access to international capital markets.

In contrast, in some countries in the Bank's region of operation, particularly those further east, progress in putting in place the institutions that underpin a market economy has been limited, and the process of liberalization and privatization is far from complete. As a result, economic growth remains vulnerable to external and internal shocks. In addition, the significant increase in poverty and inequality since the start of transition has eroded support for necessary reforms in many countries. Overcoming resistance to reform will be a challenge; it will require creating new employment opportunities and social fallback options for those displaced by structural change, and breaking the hold of powerful vested interests over the reform process.

Good governance will continue to play a critical role in the future success of the region and, in this regard, the EBRD will need to find ways to conduct its business to promote its Article 1 commitment to the principles of multi-party democracy and pluralism. Attention to governance issues in Central Asia, and in Uzbekistan in particular, will be centre stage in 2004, as the Bank will assess that country's progress towards meeting key political benchmarks. Specifically, the Bank will be looking for evidence of greater political openness and media freedom, the free functioning of independent civil society groups and implementation of the recommendations of the UN Special Rapporteur on Torture. This assessment will also include a stock-taking of the country's progress towards meeting the EBRD's economic benchmarks. The level of future Bank operations in Uzbekistan will depend on this assessment being positive. Canada will continue its vigorous support for Bank efforts to address issues related to the rule of law, human rights and democratic principles.

Good corporate governance will also figure prominently in the period ahead, and the EBRD will need to continue to promote sound institutions, more efficient tax collection and improved legal and regulatory frameworks. It must ensure not only that appropriate legislation is developed, but also that it is properly implemented and enforced.

Finally, good governance within the EBRD itself is also important. Since the EBRD, as a multilateral institution, is not regulated, the Bank must push itself more to adopt and maintain the highest industry standards. To this end, a process is underway to review the Bank's governance standards with a view to strengthening them where needed. In particular, in light of recent problems in the private sector, the role of the Audit Committee is being examined to ensure that it is guided by the best and most appropriate standards.

Contacting the Office of the Director for Canada

The Canadian Director's office at the EBRD may be reached at:

Office of the Director for Canada and Morocco
European Bank for Reconstruction and Development
One Exchange Square, Room 8.15
London, EC2A 2JN
United Kingdom

Mr. C. Scott Clark, Director	Tel: +44 20 7338 6457
Mr. David Plunkett, Alternate Director[1]	Tel: +44 20 7338 6507
Ms. Michelle Kaminski, Advisor[2]	Tel: +44 20 7338 6458 E-mail: kaminskm@ebrd.com
Ms. Sandy Ferguson, Advisor[3]	Tel: +44 20 7338 6509 E-mail: fergusos@ebrd.com
Ms. Alicja Krivicky, Executive Secretary	Tel: +44 20 7338 6507 E-mail: krivicka@ebrd.com Fax: +44 20 7338 6062

[1] Resident at the Canadian High Commission in London.

[2] Responsible for policy matters.

[3] Responsible for business development and investor liaison.

For More Information on the EBRD

The Bank releases considerable information on its various activities. Bank publications include information guides (such as *Financing With the EBRD*), special reports (such as the *Annual Report* and *Transition Report*), country strategies and assorted fact sheets.

Information can also be obtained on the Bank's Web site:

http://www.ebrd.com/

Requests for information can be addressed to:

Publications Desk
European Bank for Reconstruction and Development
One Exchange Square
London, EC2A 2JN
United Kingdom
(Fax: +44 20 7338 7544)

Annex 1

The Bank's Financial Activities

The Bank's financial activities are divided into ordinary and special operations, depending on the source of funds. Ordinary operations are financed from the ordinary capital resources of the Bank, which comprise subscribed capital, market borrowings, and income from loans and investments. Special operations are those financed by "special funds" for specially designated purposes that are typically outside the Bank's regular activities. Unlike other regional development banks, however, the EBRD does not operate a concessional or "soft" loan window.

Ordinary Capital Resources

At the end of 2003, the total authorized capital of the Bank was €20 billion. Canada has subscribed to 3.4 per cent—or €680 million (C$958 million)—of the Bank's authorized capital. Canadian contributions to the Bank's capital are made in US dollars (at a pre-determined euro/US$ exchange rate).

In 2003, Canada made its sixth purchase of shares under the first capital increase (which came into effect on April 3, 1997, and doubled the initial €10-billion capital base). Under the first capital increase, 77.5 per cent of Canada's share is "callable," meaning that the Bank can request these resources in the unlikely event that it requires them to meet its financial obligations to bondholders; the balance, or 22.5 per cent, is "paid-in." Payments are being made in eight equal annual installments (40 per cent in cash and 60 per cent in non-interest-bearing demand notes encashed over five years). The table on the next page details Canadian payments to the Bank in US dollars.

Canada's contributions to the Bank's capital are non-budgetary expenditures because our shares in the Bank are considered an asset. Nonetheless, Canada's paid-in contributions to the Bank do increase the Government's financing requirements.

Canadian Payments to the EBRD

Year	Notes	Cash	Encashment of notes	Total cash outlay
		(in US dollars)		
1991	11,903,502	11,903,502	11,903,502	23,807,004
1992	11,903,502	11,903,502	3,967,834	15,871,336
1993	11,903,502	11,903,502	7,935,668	19,839,170
1994	11,903,502	11,903,502	11,903,502	23,807,004
1995	11,903,502	11,903,502	11,903,502	23,807,004
1996	–	–	7,935,668	7,935,668
1997	–	–	3,967,834	3,967,834
1998	7,287,199	4,858,132	1,457,440	6,315,572
1999	7,287,199	4,858,132	2,914,879	7,773,011
2000	7,287,199	4,858,132	4,372,319	9,230,451
2001	7,287,199	4,858,132	5,829,759	10,687,891
2002	7,287,199	4,858,132	7,287,198	12,145,331
2003	7,287,199	4,858,132	7,287,199	12,145,331
Total	103,240,702	88,666,304	88,666,305	177,332,609

Market Borrowings

At the end of 2003, total EBRD borrowings stood at €14.2 billion with an average maturity of 8.8 years at an average cost of funds of LIBOR (London Inter-Bank Offered Rate) minus 41 basis points. Funds have been swapped into floating-rate instruments, primarily in US dollars, euros and Deutsche Marks.

Standard & Poor's has assigned the Bank an AAA long-term and A1+ short-term credit rating. Moody's Investors Service has similarly rated the EBRD long-term bonds AAA.

Special Funds

The EBRD administers a number of bilateral and multilateral technical assistance funds. Canada has contributed to the following special funds:

Canadian Technical Cooperation Fund—The main purpose of this fund is to provide financing to hire Canadian consultants for EBRD projects. Canada has contributed C$12.65 million since the fund was established in 1992.

Chernobyl Shelter Fund—The main purpose of this fund is to secure the sarcophagus around the destroyed Unit IV nuclear reactor in Ukraine. The total estimated cost of this 10-year project is roughly US$1 billion, of which US$716 million has been pledged so far. Canada has pledged US$33 million, including US$0.8 million of bilateral assistance for ventilation stack repair.

Nuclear Safety Account (NSA)—This facility was established in 1993 to help finance the closure of the Chernobyl nuclear power plant and to improve safety conditions at nuclear power plants in countries of operations until the plants can be closed. The NSA complements other bilateral and multilateral nuclear safety technical assistance and functions in parallel with multilateral efforts to achieve broader energy sector reform in the region. Canada has contributed C$19.5 million to the total fund of €273 million. Canada's contribution has been completely disbursed.

Russia Small Business Fund (RSBF)—The purpose of this fund is to establish a facility for small business finance and micro lending in various regions of Russia. The RSBF was established in 1993 as a pilot project and became permanent in 1995. Canada has contributed C$11.3 million towards the US$300-million fund.

CIDA-EBRD Cooperation Fund for Southeastern Europe (CFSEE)—By 2002, Canada had contributed $10 million in support of the EBRD's South Eastern Europe Action Plan, to be used for technical cooperation and co-financing activities. These funds, tied to Canadian consultants, were used in Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FYR Macedonia, Romania, and Serbia and Montenegro. In 2003, an additional $6 million was added to the CFSEE, which will focus on CIDA priority sectors and countries of focus until 2010.

CIDA-EBRD Balkan Region Special Fund (BRSF)—In addition to the CFSEE, Canada has contributed $2 million to the united Balkan Region Special Fund to support post-conflict reconstruction efforts in the Balkan region.

TurnAround Management (TAM) Programme—The TurnAround Management Programme was established in 1993 to match senior industrial advisors from market-driven economies with chief executives of selected firms in the region. The objective is to provide industrial management know-how and develop business skills so that these companies can become competitive and profitable. In 2003, Canada signed a new agreement with the TAM Programme to provide $2.5 million over five years to be used to hire Canadians to work as advisors. This brought Canada's total contribution to the TAM Programme to $3,050,000.

Ukraine Micro Finance Bank (MFB)—In 2000, Canada entered into a contribution agreement with the EBRD to provide C$1.25 million for the provision of technical assistance related to the development of the MFB. Over three years, Canada has assisted the MFB to develop a branch network throughout Ukraine, with special attention being paid to Slavutych, the community where many former employees of the Chernobyl nuclear power plant reside. As a greenfield operation specializing in financial services for the micro and small enterprise sector, the MFB is also serving as a demonstration bank for the Ukrainian commercial banking sector to show the commercial viability of micro and small enterprise lending.

Technical assistance in support of the Ukraine Micro, Small and Medium-Sized Enterprises Line of Credit II—Between 1999 and 2004, Canada will provide C$3 million for technical assistance services by qualified Canadian organizations to Ukrainian commercial banks receiving loans under the EBRD's Ukraine Micro, Small and Medium-Sized Enterprises Line of Credit II for on-lending to micro, small and medium-sized enterprises. The technical assistance has included risk- and loan-evaluation training.

Northern Dimension Environment Partnership (NDEP)—NDEP is a partnership among the Russian Government, international financial institutions and bilateral donors to address environmental problems in northwest Russia, including nuclear waste disposal. Canada has contributed €20 million to the NDEP's nuclear window.

Annex 2

Doing Business With the EBRD

For general information, please refer to www.infoexport.gc.ca/ifinet or contact the Bank's Communications Department in London (tel: +44 20 7338 6096; fax: +44 20 7448 6690).

Further inquiries should be directed to the Office of the Director for Canada, Advisor for Business Development and Investor Relations, Ms. Sandy Ferguson (tel: +44 20 7338 6509; e-mail: fergusos@ebrd.com).

Canadian Project Sponsors: Canadian companies interested in potentially sponsoring a project with the EBRD are requested to direct initial inquiries either to Project Inquiries in London (tel: +44 20 7338 6282 or +44 20 7338 6252; fax: +44 20 7338 6102) or to the Bank's resident office in the country of operation. Summaries of EBRD private sector operations can be obtained on the Bank's Web site at http://www.ebrd.com/.

Canadian Suppliers of Goods and Works: The EBRD makes available information on all stages of public sector project development, from the point a project has been identified by the Bank through to its approval. Procurement opportunities and co-financing notices, as well as contract awards information, can be accessed on the Bank's Web site free of charge (see address above).

Canadian Consultants: The EBRD's Web site contains technical cooperation notifications and invitations for expressions of interest for consultancy services pertaining to both public and private sector projects. The EBRD is currently working on an e-Procurement initiative. This initiative will involve the selection of consultants through a web based process.

Current procurement information can be found at http://www.ebrd.com/oppor/procure/index.htm

Individual Canadians: The EBRD maintains a recruitment section on its Web site, which provides information on specific employment competitions at the Bank as they become available. In general, applications for employment for both permanent positions and summer jobs should be sent to:

Paolo Gallo, Director for Human Resources
Human Resources Management Department
European Bank for Reconstruction and Development
One Exchange Square
London, EC2A 2JN
United Kingdom

Annex 3

EBRD Membership as at December 31, 2003

	Share of the Bank's capital
	(%)
European Members	
Austria	2.28
Belgium	2.28
Cyprus	0.10
Denmark	1.20
Finland	1.25
France	8.52
Germany	8.52
Greece	0.65
Iceland	0.10
Ireland	0.30
Israel	0.65
Italy	8.52
Liechtenstein	0.02
Luxembourg	0.20
Malta	0.01
Netherlands	2.48
Norway	1.25
Portugal	0.42
Spain	3.40
Sweden	2.28
Switzerland	2.28
Turkey	1.15
United Kingdom	8.52
European Union	3.00
European Investment Bank	3.00
Non-European Members	
Australia	0.50
Canada	**3.40**
Egypt	0.10
Japan	8.52
Korea, Republic of	1.00
Mexico	0.15
Mongolia	0.01
Morocco	0.05
New Zealand	0.05
United States	10.00

	Share of the Bank's capital
	(%)
Countries of Operations	
Albania	0.10
Armenia	0.05
Azerbaijan	0.10
Belarus	0.20
Bosnia and Herzegovina	0.17
Bulgaria	0.79
Croatia	0.36
Czech Republic	0.85
Estonia	0.10
FYR Macedonia	0.07
Georgia	0.10
Hungary	0.79
Kazakhstan	0.23
Kyrgyzstan	0.10
Latvia	0.10
Lithuania	0.10
Moldova	0.10
Poland	1.28
Romania	0.48
Russia	4.00
Serbia and Montenegro	0.47
Slovak Republic	0.43
Slovenia	0.21
Tajikistan	0.10
Turkmenistan	0.01
Ukraine	0.80
Uzbekistan	0.21

Report on Operations Under the European Bank for Reconstruction and Development Agreement Act 2004

Canada

Report on Operations Under the European Bank for Reconstruction and Development Agreement Act

2004

Prepared by:
International Trade and Finance Branch
March 2005

Department of Finance Canada
Ministère des Finances Canada

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INTRODUCTION

The European Bank for Reconstruction and Development (referred to in this document as the EBRD or the Bank) was established in 1991. Its aims are to foster the transition towards open, market-oriented economies in Central and Southeastern Europe, as well as in the successor states of the former Soviet Union,[1] and to promote private and entrepreneurial initiative in those countries that are committed to the fundamental principles of multi-party democracy, pluralism and a market economy (see Annex 3 for a list of the EBRD's 27 countries of operations).

The EBRD differs from other multilateral development banks in four ways. First, its overriding focus is the private sector and support for the transition from central planning to stable market economies. Its charter stipulates that not less than 60 per cent of its financing commitments should be directed either to private sector enterprises or to state-owned enterprises implementing a program to achieve private ownership and control. Second, it has a particular focus on the promotion of democratic institutions and human rights in its countries of operations. Third, while all multilateral development banks are committed to ensuring the environmental sustainability of their projects, the EBRD is the only such institution where this commitment is explicitly written into its Articles of Agreement. Fourth, the EBRD does not provide concessional financing.

The Bank seeks to help its 27 countries of operations to implement structural and sectoral economic reforms, taking into account the particular needs of countries at different stages in the transition process. In particular, its private sector activities focus mainly on enterprise restructuring, including the strengthening of financial institutions, and the development of infrastructure needed to support the private sector. The EBRD has 62 members: 60 countries, the European Union (EU) and the European Investment Bank (see Annex 3 for a list of members).

Canada is the eighth largest shareholder (tied with Spain), following the other Group of Eight (G-8) countries. Canada's formal participation is authorized under the European Bank for Reconstruction and Development Agreement Act, which was promulgated in February 1991. Article 7 of the Act states that:

> The Minister [of Finance] shall cause to be laid before each House of Parliament by March 31 of each year or, if that House is not then sitting, on any of the thirty days next thereafter that it is sitting, a report of operations for the previous calendar year, containing a

[1] In 2004, Governors voted to make Mongolia a country of operations, recognizing its close linkage with the former Soviet economy and its long history with a centrally planned economy. This process will not be complete until all members adopt the necessary amendment to their domestic legislation governing their relations with the Bank.

general summary of all actions taken under the authority of this Act, including their sustainable development aspects within the meaning of Article 2 of the Agreement, and their human rights aspects.

This report responds to this requirement and reviews the activities and operations of the Bank for the year 2004.

BENEFITS OF MEMBERSHIP

As a major trading nation, Canada has a stake in global peace and stability, which the successful integration of Central and Southeastern Europe and the former Soviet Union into the world economy and global institutions helps to promote. By fostering continued political and economic reform in the region, the EBRD is contributing to its integration into the world economy and to its stability.

The Minister of Finance is a Governor of the Bank and nominates a Director to its 23-member Board. This representation allows Canada to have high-level influence on decisions taken by the EBRD on investments in the region and on policies to move countries through the transition process. The EBRD also provides trade opportunities for the Canadian private sector, supporting a diversification of international markets for Canadian businesses.

Details on Canada's financial contributions to the EBRD are provided in Annex 1.

The EBRD

- fosters the transition of former centrally planned economies of Central and Southeastern Europe and the successor states of the former Soviet Union towards market-oriented economies;
- promotes private entrepreneurial initiative by targeting at least 60 per cent of its resources to private sector projects, with the balance in support of commercially viable state sector projects that promote private sector development;
- operates only in countries committed to applying the principles of multi-party democracy, pluralism and market economics;
- promotes environmentally sound and sustainable development; and
- operates on a self-financing basis.

Role and Mandate of the EBRD

The EBRD's operations to advance the transition to a market economy are guided by three principles: maximizing transition impact, additionality, and sound banking. Financing is provided for projects that expand and improve markets, help to build the institutions necessary for underpinning a market economy, and demonstrate and promote market-oriented skills and sound business practices. EBRD financing must also be additional to other sources of financing and not displace them, further ensuring that the Bank contributes to the transition process. Finally, Bank projects must be sound from a banking perspective, thus demonstrating to private investors that the region offers attractive returns. Adherence to sound banking principles also helps to ensure the financial viability of the EBRD and hence its attractiveness as a co-investment partner for the private sector.

In promoting economic transition in its countries of operations, the Bank acts as a catalyst for increased flows of financing to the private sector. The capital requirements of these countries cannot be fully met by official multilateral or bilateral sources of financing, and many foreign private investors remain hesitant to invest in the region, particularly the central Asian republics. By providing an umbrella under which wider funding for private sector investment can be assembled, the EBRD plays a catalytic role in mobilizing capital. In 2004, for every euro the EBRD invested, it mobilized an additional 2.1 euros from the private sector and other multilateral and bilateral agencies.[2] Commercial co-financing mobilized by the EBRD reached a record volume of 3.5 billion euros in 2004, up 34 per cent from the previous high in 2003.

The Bank's projects serve a dual purpose. They are intended not only to directly support the transition from a command to a market economy in countries of operations, but also to create a demonstration effect to attract foreign and domestic investors. Like the World Bank Group's International Finance Corporation, the Bank is required to operate on a strictly commercial basis and to attract companies through financially viable projects, not through subsidies.

[2] On December 31, 2004, one euro purchased 1.6292 Canadian dollars.

Key Economic Developments in 2004

Most of the transition economies experienced economic growth in 2004, accompanied by a rapid rise in domestic bank lending that has boosted investment and consumption. Most countries in the region continued to perform well in comparison with other emerging markets. The exception continues to be the poorer countries in the Commonwealth of Independent States (CIS),[3] where the reform process continues to lag and uncertain climates continue to discourage domestic and foreign investment.

The process of transition to market-based economies continued to advance in most of the EBRD's countries of operations. Belarus, Turkmenistan and Uzbekistan are the exception, with reform largely stalled at a very early level of transition. The results of the Bank's annual assessment of key transition indicators are summarized in the following table.

[3] The CIS includes Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, the Kyrgyz Republic, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan.

Progress in Transition in EBRD Countries of Operations

Countries	Population (millions, mid-2004)	Private sector share of GDP in %, mid-2004 (EBRD estimate)	Enterprises: Large-scale privatization	Enterprises: Small-scale privatization	Enterprises: Governance and enterprise restructuring	Market and trade: Price liberal-ization	Market and trade: Trade and foreign exchange system	Market and trade: Compe-tition policy	Financial institutions: Banking reform and interest rate liberalization	Financial institutions: Securities markets and non-bank financial institutions	Infra-structure: Infra-structure reform
Albania	3.2	75	2+	4	2	4+	4+	2▲	3-▲	2-	2
Armenia	3.1	75▲	3+	4▲	2+	4+	4+	2	2+	2	2+
Azerbaijan	8.3	60	2	4-	2+	4	4-	2	2+	2-	2
Belarus	9.9	25	1	2+	1	3-	2+	2	2-	2	1+
Bosnia and Herzegovina	3.8	50	2+	3	2	4	4-	1	3-▲	2-	2+
Bulgaria	7.8	75	4▲	4-	3-	4+	4+	2+	4-▲	2+	3▲
Croatia	4.4	60	3+	4+	3▲	4	4+	2+	4▲	3-	3▲
Czech Republic	10.3	80	4	4+	3+	4+	4+	3	4-	3+▲	3+
Estonia	1.4	80	4	4+	3+	4+	4+	3-	4▲	3+	3+
FYR Macedonia	2.0	65▲	3+▲	4	2+	4	4+	2	3-	2▲	2
Georgia	4.6	65	3+	4	2	4+	4+	2	3-▲	2-	2+
Hungary	10.0	80	4	4+	3+	4+	4+	3	4	4-	4-
Kazakhstan	14.4	65	3	4	2	4	3+	2	3	2+	2+
Kyrgyz Republic	4.8	75▲	4-▲▲	4	2	4+	4+	2	2+	2	2-▲
Latvia	2.3	70	4-	4+	3	4+	4+	3-	4-	3	3
Lithuania	3.5	75	4-	4+	3	4+	4+	3	3	3	3-
Moldova	4.3	50	3	3+	2-	4-	4+	2	3-▲	2	2
Poland	38.3	75	3+	4+	3+	4+	4+	3	3+	4-	3+
Romania	21.7	70▲	4-▲	4-	2	4+	4+	2+	3▲	2	3+▲
Russia	144.9	70	3+	4	2+	4	3+	2+	2	3-	3-▲
Serbia and Montenegro	8.3	50	2+	3+▲	2	4	3+	1	2+	2	2
Slovak Republic	5.4	80	4	4+	3	4+	4+	3	4-▲	3-	3-
Slovenia	2.0	65	3	4+	3	4	4+	3-	3+	3-	3
Tajikistan	6.5	50▲	2+	4-	2-	4-	3+	2-	2▲	1	1+
Turkmenistan	6.0	25	1	2	1	3-	1	1	1	1	1
Ukraine	48.4	65	3	4	2	4	3	2+	2+	2+▲	2
Uzbekistan	26.0	45	3-	3	2-	3-	2-	2-	2-	2	2-

Note: The classification of transition indicators uses a scale from 1 to 4, where 1 implies little or no progress with reform and 4 implies a market economy. A rating of 4+ indicates the country has achieved standards and performance typical of advanced industrial economies. ▲ arrow indicates change from the previous year. One arrow indicates a movement of one point (from 4 to 4+, for example) and two arrows a movement of two points.

Source: EBRD, 2004 *Transition Report*.

Russia

Russia's economic growth is estimated to have slowed to 7.1 per cent in 2004, down from 7.3 per cent in 2003. Economic growth continued to be driven by high oil prices, increasing oil export volumes and stronger investment, which was mainly directed to the energy sector. High taxation revenues from the oil and gas sectors led to a fifth straight budgetary surplus in 2004 and allowed the Oil Stabilization Fund to reach the equivalent of US$19 billion by year-end.

Monetary policy continued to be guided by the dual objective of reducing inflation and limiting real appreciation of the ruble. The central bank continued to intervene heavily in the foreign exchange market in 2004, allowing Russian authorities to increase their foreign exchange reserves to a record-high US$125 billion by the end of 2004. Difficulties in sterilizing this rapid reserve accumulation have, however, resulted in a surge in money growth, which in turn has contributed to higher-than-expected inflation. Year-end consumer price inflation in 2004 was 11.7 per cent, well above the initial official target of 8–10 per cent.

There are growing concerns that Russia's oil-driven boom may be losing steam. These concerns have led Russian authorities to decrease their 2005 growth forecast to 5.8 per cent. In order to promote more sustainable growth, Russia needs to diversify its economy by implementing structural reforms aimed at increasing economic activity in the non-energy sector and at improving the overall investment climate. Russia's investment climate was clouded in 2004 by concerns of growing government interference in the economy, triggered by the Yukos affair. Concerns about the business climate contributed to net capital outflows of US$7.8 billion in 2004, quadruple 2003's outflow. Unless structural reforms enable other sectors of the economy to develop, Russia's dependence on natural resource exports will increase, and economic growth will continue to fluctuate in tandem with oil and other raw material prices.

Other CIS Countries

Other oil-exporting CIS countries continued their rapid economic growth in 2004. This strong growth largely reflected revenue from sustained high oil prices and rising fixed investment in resource-based sectors. Kazakhstan recorded the strongest economic growth among oil-exporting CIS countries in 2004, with estimated real gross domestic product (GDP) growth of 9.4 per cent, mainly due to a continuing investment boom in the oil and gas-related sectors. Azerbaijan also maintained strong growth momentum at 7.8 per cent in 2004, fuelled by the construction of the Baku-Tbilisi-Ceyhan pipeline, which will begin operations in mid-2005.

Many of the remaining CIS countries have also benefited from high non-oil commodity prices. These include Ukraine (steel), Tajikistan (aluminum), the Kyrgyz Republic (gold) and Uzbekistan (gold). High commodity prices have also had positive indirect effects on other economic sectors, such as services and construction. Despite its year-end political crisis, Ukraine is estimated to have recorded real GDP growth of 12.0 per cent in 2004, up from 9.4 per cent in 2003. Decisive action to address double-digit inflation and large increases in government spending will be crucial, however, to deal with the mounting pressures on the economy. Growth rates in Tajikistan, the Kyrgyz Republic and Uzbekistan all increased in 2004 compared to the previous year, although per capita incomes in these countries still remain very low relative to other CIS countries.

Reforms must urgently address the chronically poor investment climates and weak institutions if these countries are to enjoy stronger growth over the medium and longer term.

Central Europe[4]

In 2004, the economies of Central Europe grew by an average of 4.9 per cent, up from 3.8 per cent in 2003, driven primarily by domestic demand and increasingly by an expansion of exports.

The Baltic States continued to register strong growth in 2004, led by Latvia, which grew by 8.5 per cent for the second consecutive year. All Central Eastern European countries recorded significant real GDP growth in 2004. In particular, growth in Poland increased strongly to 5.4 per cent, up from 3.8 per cent in 2003, buoyed by exports and investment. Growth in Hungary also picked up, rising from 2.9 per cent in 2003 to 4.0 per cent in 2004.

Economic conditions across the region contributed to the improvement in government deficits from an average of 3.6 per cent of GDP in 2003 to 3.2 per cent of GDP in 2004. However, several large Central Eastern European countries have failed to bring their fiscal positions under control. Fiscal deficits as a per cent of GDP in Hungary (5.6), Poland (5.4) and the Czech Republic (3.4) have remained substantial, and further fiscal consolidation will be required. In order to meet the Maastricht criteria for monetary union (to join the euro), among other things these countries must reduce their public deficits to 3 per cent of GDP or less.

The average current account deficit in Central Europe remained at 5.8 per cent of GDP in 2004. High investment and consumption levels, fuelled by a booming credit market (particularly for consumer finance), have led to sustained demand for imports.

[4] Includes the Czech Republic, Hungary, Poland, the Slovak Republic, Slovenia and the three Baltic States (Estonia, Latvia and Lithuania).

Following a sharp drop from 6.6 per cent of GDP in 2002 to 2.4 per cent of GDP in 2003, foreign direct investment (FDI) is estimated to have increased marginally in 2004. In Hungary and Poland, FDI inflows were replaced by less stable portfolio inflows, which have increased their vulnerability to sudden reversals in capital flows. The decline in net inflows of FDI reflects the tapering off of major privatization deals as a source of FDI, and the increasing difficulty in attracting greenfield investments.

Accession to the European Union

2004 marked a milestone in the EBRD's short history, with 8 of its 27 countries of operations joining the EU on May 1 (the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic and Slovenia). As the transition process advanced in Central Europe, the Bank began to slowly shift its operations to the less advanced transition countries, particularly as it begins to implement the newly approved Early Transition Countries Initiative.[5] In line with its principles of transition impact, sound banking, and additionality, the EBRD also sharpened the focus of its operations in the advanced transition countries. The beneficiaries of EBRD operations in these countries are now largely small and medium-sized municipalities that cannot obtain funds elsewhere without a sovereign guarantee and small and medium-sized enterprises that require equity or longer-term commercial financing on reasonable terms. Co-financing with EU structural funds also figures in the Bank's activities in the new EU countries.

Southeastern Europe[6]

Increased political stability, although still fragile in some cases, and the prospects of EU membership for Bulgaria (for entry in 2007), Romania (for entry in 2007), and Croatia (accession negotiations to begin in April 2005) are motivating structural reform and economic growth in Southeastern Europe.

Average real GDP growth increased from 4.4 per cent in 2003 to 5 per cent in 2004. Growth in Albania and Romania has been particularly strong (6.2 and 8.0 per cent, respectively). Only FYR Macedonia (2.5 per cent) is lagging behind the region, which is partly due to persistently low per capita net FDI inflows.

[5] Advanced transition countries include Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic and Slovenia. The early transition countries are the Bank's seven poorest countries of operations: Armenia, Azerbaijan, Georgia, the Kyrgyz Republic, Moldova, Tajikistan and Uzbekistan. Intermediate transition countries include the balance of the EBRD's countries of operations, excluding Russia. The EBRD considers Russia to be in a category of its own.

[6] Southeastern Europe includes Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the Former Yugoslav Rėpublic of Macedonia (FYR Macedonia), Romania, and Serbia and Montenegro.

Throughout the region, rapid real GDP growth has been associated with the expansion in bank lending (domestic bank lending grew by 23 per cent in 2003), leading to higher consumption levels. Credit has expanded particularly quickly in Bulgaria and Romania. Excessive credit growth, however, can lead to vulnerabilities in the financial sector, with possible repercussions for public and corporate sector creditworthiness and exchange rate stability. This has prompted the introduction of tighter regulations on bank lending in many countries.

General government deficits averaged less than 3 per cent of GDP in 2004. Albania and Croatia were the only countries with fiscal deficits above this level. In contrast, FYR Macedonia reduced its deficit to around 1 per cent of GDP, reflecting significant fiscal consolidation.

Current account deficits remained large throughout the region, averaging 8.8 per cent of GDP. In Bulgaria, the current account deficit remained above 8 per cent due to the credit-fuelled consumption boom.

In contrast to Central Europe, net FDI into Southeastern European countries has remained at historically high levels for the second year in a row. This has mainly been generated by large privatization contracts. The increase in net FDI inflows—and the simultaneous decrease of flows into Central Europe—also partly result from European investors relocating business activities to Southeastern European countries, with the aim of taking advantage of lower unit labour costs and taxation levels than those in some Central European countries.

Canada's Cooperation With the EBRD in Southeastern Europe

In response to the Kosovo crisis in 1999, the EBRD developed the South Eastern Europe Action Plan (SEEAP), which seeks to promote investment and to assist in the economic recovery of the region. Eligible countries are Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FYR Macedonia, Romania, and Serbia and Montenegro.

Under the SEEAP, EBRD investments focus on developing commercial approaches to infrastructure (such as telecommunications, airports, and municipal and environmental infrastructure), micro, small and medium-sized enterprises, and the financial sector. These investments address the transition challenges facing the region: crumbling infrastructure; a weak industrial asset base; mostly small, fragile banks; and pervasive problems of poor governance.

To date, Canada, through the Canadian International Development Agency (CIDA), has committed $18 million in support of the EBRD's SEEAP activities. The total Canadian contribution is being used for technical assistance and co-financing related to project preparation and implementation, advisory services, and capacity building. Canada's assistance is contributing to the efforts of both the EBRD and the international community in supporting the transition process and in promoting stability in the region.

In 2000, CIDA committed a total of $12 million to Phase I of the CIDA-EBRD Cooperation Fund for Southeastern Europe (CFSEE), of which $2 million was designated for the Balkan Region Special Fund (BRSF) to support post-conflict reconstruction efforts in the Balkan region. The total amount ($12 million) has been earmarked against 36 projects approved by CIDA—26 against the BRSF and 10 against the CIDA-EBRD CFSEE Program.

In March 2003, CFSEE Phase II, valued at $6 million, was launched. Phase II builds upon the results of Phase I and adheres to a more focused programming approach in line with CIDA's Strategy for the Balkans Region. In Phase II, Canadian funding is targeted to countries that CIDA identified as priority countries—Bosnia and Herzegovina, and Serbia and Montenegro. Projects with a regional focus are also supported under Phase II and these may include other countries in the Balkans.

2004 *Transition Report*

The *Transition Report* is an annual publication of the EBRD that charts the progress of transition from a centrally planned to a market economy in each of the Bank's 27 countries of operations. The *Transition Report* is recognized as the leading publication analyzing the progress of transition in the former Soviet bloc. Infrastructure, and the private sector's role in its provision, was chosen as the special theme of the 2004 report in recognition of the shift in thinking about infrastructure. Apart from the EBRD, international financial institutions (IFIs) had reduced their involvement in core infrastructure services on the assumption that, with proper regulation, the private sector could finance and operate these services. However, the expected private financing did not materialize. Contributing factors were the global economic slowdown (2000–2003) and the coinciding crises in the international telecommunications and electricity markets that led to a scaling back of private sector investment in emerging markets. Thus, realizing that good infrastructure is essential for economic development and poverty alleviation and that the private sector will not do it alone, infrastructure is back on the IFIs' agendas.

In the transition economies, the infrastructure challenges are maintaining and upgrading service networks and developing rules and regulations that encourage efficient, cost-effective, environmentally sustainable and affordable services. The 2004 *Transition Report* assesses the potential contribution the private sector can make to infrastructure, and suggests past expectations were too high. The changing nature of private sector participation, with the private sector increasingly providing management skills rather than capital investment, will make the arrangements less risky for both the government and private sector partners. It suggests that strengthening regulatory institutions and removing political constraints can improve the success of private sector participation. Tariff reform is a particularly challenging area, and the report suggests that innovations, including "lifeline" tariffs that allow a certain level of services to be provided free of charge, offer a way to address equity concerns while improving the overall efficiency of services.

2004 Financial Results

In 2004, the EBRD realized another strong financial performance with profits after provisions of €297.7 million, below last year's figure of €378.2 million but significantly higher than previous years. The EBRD continued to see a reduction in its impaired assets (non-performing loans) in 2004. At December 31, 2004, the EBRD had €86 million in impaired loans, compared with €125.2 million at the end of 2003. The EBRD's general administrative expenses in 2004 were £138.1 million, compared to £132.8 million in 2003.

Financial Highlights

- The Bank recorded €4.1 billion of new operations in 2004, an increase of €400 million from 2003. Of this amount, 47 per cent was approved for early and intermediate transition economies in the former Soviet Union and Southeastern Europe. Another 23 per cent went to the advanced transition countries of Central Europe and 30 per cent to Russia.
- As the institution reports its financial results in euros, the depreciation of the US dollar in 2004 reduced the euro value of EBRD operations, given that many of its operations (and especially those in CIS countries) are transacted in US dollars.
- Profits after provisions were €297.7 million, down from €378.2 million in 2003 but significantly higher than in past years.
- Total provisions on banking assets were €1.1 billion at the end of 2004, the same as at the end of December 2003.
- Gross disbursements, at €3.4 billion, were up strongly (60 per cent) from 2003.
- The Bank mobilized €2.1 in additional financing for every euro that it invested in 2004, compared to €1.4 in 2003.
- The private sector share of annual business volume was 86 per cent, up from the 79 per cent reported in 2003 and the highest share to date.
- Administrative expenses were £138.1 million, continuing a 10-year trend of no real increases in approved budgets. Indeed, actual administrative expenses in 2004 were once again somewhat below the approved budget for the year.
- Reserves[7] at the end of 2004 were €1,786 million, up sharply from €989.6 million at the end of 2003, primarily reflecting net profits for the year and an increase in the fair value of the Bank's listed share investments.

[7] Reserves are Bank capital set aside to cover unexpected losses.

The EBRD approved 129 projects in 2004, up from 119 the previous year. These commitments totalled €4.1 billion, up from €3.7 billion in 2003, surpassing the €3.5-billion to €3.9-billion target range of the Bank's medium-term operational strategy. Net cumulative commitments by the end of 2004 amounted to €15.4 billion, breaking the €15-billion threshold for the first time. The level of disbursements, at €3.4 billion, was over 60 per cent above the €2.1 billion recorded in 2003. Net disbursements were particularly high in the early and intermediate transition countries, and slightly negative in the advanced transition countries (due to strong reflows from these countries). Guarantees decreased by 24 per cent to €180 million at the end of 2004.

Even as the Bank increases its emphasis on the early transition countries—where the investment climate is particularly risky—it continues to follow sound banking principles, as the overall financial performance for 2004 indicates.

Institutional Developments

Early Transition Countries Initiative

In early 2004, the Bank launched a new initiative for the seven early transition countries (ETCs). With the accession of eight of the Bank's borrowing members to the EU, it has become increasingly necessary for the Bank to shift its focus to its less advanced borrowing members. The new initiative aims to stimulate market activity in these countries by using a streamlined approach to financing more and smaller projects, mobilizing more investment, and encouraging ongoing economic reform. Governors agreed that the Bank should accept higher risk in the projects it finances for the ETCs, while still respecting the principles of sound banking. The Bank has established a Multi-Donor Trust Fund to help support this new initiative. This fund will coordinate grants, financed by bilateral donors, to catalyze investment in these countries by paying for technical cooperation, advice on regulatory and governance improvements, and co-financing for investments with widespread economic and social impact.

Reflecting the Bank's comparative advantages, the ETC strategy will emphasize private sector development, particularly in micro, small and medium-sized enterprises. The Bank is currently developing or refining several financing instruments dedicated to the funding of local entrepreneurs and enterprises. The initiative also promotes financing of smaller government infrastructure investments appropriate to local consumers' ability to pay for improvements in these services (e.g. water, heating).

Excluding oil and gas extraction and pipeline projects, the Kumtor restructuring and the Azerbaijan Silk Road project (major investments not directly affected by the new strategy), business volume increased from €84 million in 2003 to €93 million in 2004, encouraged by the ETC Initiative.

Private Sector Development

Fostering the development of strong private sectors in its countries of operations is an essential element of the EBRD's strategy for promoting the transition to a market economy. A strong small and medium-sized enterprise (SME) sector is one means of developing a "constituency for reform" in the transition economies that can act as a counterweight to powerful vested interests that benefit from weak state governance. The Bank's Articles require it to commit at least 60 per cent of its portfolio to private sector activities, both globally and in individual countries. The global portfolio ratio was first satisfied in 1994 and has grown to a record high of 86 per cent in 2004.

A core part of the EBRD's work with the private sector is its support of micro, small and medium-sized enterprises (MSMEs), which are important engines for job creation and growth, and therefore poverty reduction. The Bank's strategy for the MSME sector is founded on three pillars: financing, improving the investment climate through policy dialogue, and developing business support networks for MSMEs. The strategy explicitly recognizes that the poor investment climate, and not just limited access to financing, is a major impediment to the development of the sector. The strategy emphasizes the need to identify and promote the removal of the main obstacles to MSME growth, as well as to encourage the development of strong business associations. In 2004, the Board began to examine the Bank's MSME policy with a view to renewing it in 2005, to reflect lessons learned and the changing external environment.

In 2004, the Bank established, with the EU, a €60-million program under their joint SME finance facility specifically to bridge a gap in finance in rural areas of the EU accession countries. The new "Rural Sub-Window" will help address the inability of many agricultural businesses and rural enterprises to obtain adequate short- or long-term finance by extending loans and strengthening the capacity of local financial intermediaries.

In 2004, the EBRD continued its strong focus on supporting credit lines for SMEs through financial intermediaries in its countries of operations. Since the Bank's first small business program was established in 1994, more than 800,000 loans worth more than €4.0 billion have been disbursed to small and micro businesses. In 2004, the EBRD disbursed 329,000 loans for small and micro enterprises, totalling roughly €1.5 billion.

Activities in the Financial Sector

Financial Sector Policy—The EBRD's financial sector policy takes a country-specific approach to financial sector development, focusing on the need to promote confidence and competition in an independent financial system. The EBRD seeks to strengthen confidence in the sector primarily by helping to improve local institutions' governance and business practices. It also tries to improve financial supervision and regulation, although its activities here are constrained by its investor role in the sector and potential concerns about

conflict of interest. Nonetheless, as a reputable foreign investor in the sector, the EBRD offers important insights on supervisory and regulatory requirements, which it shares with other international financial institutions operating in the region and with governments. To address competition and independence, EBRD investments attempt to increase the diversity of institutions and services available (particularly to the private sector and SMEs), facilitate foreign direct investment and strengthen the commercial orientation of state-owned financial institutions, particularly in preparation for privatization.

In 2004, the EBRD committed €1.5 billion in financing to financial sector operations, representing 36 per cent of the EBRD's business volume in 2004.

Banking Sector Activities—In 2004, the EBRD signed new loans valued at €858.9 million to the banking sector, and signed equity transactions worth €197.3 million. In most cases where the EBRD holds an equity stake in a local financial institution, it is represented on the supervisory board of the institution, where it promotes management accountability, good corporate governance, sound banking practices, and appropriate environmental reviews and procedures. Participation in bank privatizations is a key factor behind equity investments in early and intermediate transition countries.

Non-Bank Financial Institutions—During 2004, the EBRD continued its support of the non-bank financial sector. New commitments of €72 million were made under the EBRD's micro and small enterprise program. The EBRD is one of the largest financial investors in this sector, with investments in local asset management and mutual fund companies becoming increasingly important as voluntary pension sectors in the Bank's countries of operations develop. By the end of 2004, the Bank had investments in the non-bank financial sector in most of the countries in the region, where necessary institutional and regulatory regimes had been or were in the process of being introduced. The EBRD also committed €174 million to insurance companies, leasing companies and specialist mortgage lending institutions in 2004, mainly in advanced transition countries.

Environment

Under its establishing Articles, the EBRD is explicitly committed to ensuring the environmental sustainability of all its projects. By investing in projects that reduce waste and pollution, the EBRD plays an important role in improving environmental standards in borrowing countries. EBRD projects have focused on upgrading municipal wastewater plants and improving energy efficiency by upgrading power generation and distribution systems. The EBRD is also assisting borrowing countries to comply with EU environmental standards. It also works with commercial financial institutions in borrowing countries to increase the profile of environmental issues in their lending policies.

In 2003, the Bank adopted a new Environmental Policy, which covers occupational health and safety issues as well as core labour standards, and expanded its public consultation process and information disclosure with respect to project environmental impact assessments. In November 2004, the

EBRD published its first annual *Environmental Report*, covering the Bank's 2003 operations. The report emphasizes the role of public consultations in ensuring a project's sustainability, and highlighted the extensive public consultations the Bank undertook in the Caucasus and in London before signing the Baku-Tbilisi-Ceyhan pipeline project. It also discusses the EBRD's contributions to reducing the emissions of greenhouse gases, including the work undertaken with the Dutch government to establish one of Europe's first carbon trading funds. Created in October 2003, the Carbon Credit Fund will invest in climate-friendly projects that reduce greenhouse gas emissions from Central Europe to Russia and Ukraine. The report also notes that the EBRD is in discussion with other countries about the establishment of similar funds.

Apart from the initiatives to specifically redress environmental weaknesses, many EBRD projects include environmental targets—for example, to reduce atmospheric emissions and industrial wastewater discharges and promote waste recovery, recycling and clean technologies. The EBRD contributes to international initiatives such as the "Environment for Europe" process, including the Environmental Action Plan for Central and Eastern Europe, the Danube River Basin Strategic Action Plan, the Helsinki Commission and the Global Environment Facility, for which it is an executing agency.

In 2004, the EBRD did not approve any projects for support under the Northern Dimension Environmental Partnership (NDEP), although the pipeline for 2005 is strong. The NDEP[8] provides donor funding to address severe environmental problems in northwest Russia, particularly in the areas of nuclear waste, water and wastewater treatment, and energy efficiency. Within the framework of its mandate, the EBRD supports relevant multilateral and regional agreements on the environment and sustainable development, including the Framework Convention on Climate Change and the measures agreed to in the Kyoto Protocol. Canada became an official contributor to the NDEP Support Fund at the end of 2003 and has committed €20 million to the "nuclear window." This contribution made Canada the NDEP's sole non-European contributor. Canada's contribution counts towards its commitment to the G-8 Global Partnership program. To deal with nuclear waste, the NDEP provides full funding within an international cooperation framework designed to address the complex challenges of cleaning up the legacy of the former Soviet navy's Northern Fleet. In 2004, on the nuclear side, the Assembly approved in principle eight priority measures, for which the EBRD is expected to develop financing proposals early in 2005.

[8] NDEP members include Russia, the EBRD, the EU, the Nordic Investment Bank, Canada, Denmark, Finland, France, Germany, the Netherlands, Norway, Sweden and the UK.

The EBRD applies environmental due diligence to all its investment and technical cooperation operations. Project sponsors are required by the Bank to undertake environmental impact assessments, analyses and audits that address potential environmental, health and safety, and socio-economic impacts of projects. Environmental impact assessments and analyses are conducted when potential impacts are significant. Environmental audits are performed post-approval. In some cases, both an audit and an assessment/analysis are performed. The EBRD also requires local financial intermediaries, through which it channels funds to micro, small and medium-sized enterprises, to adopt appropriate environmental policies and procedures.

Municipal and Environmental Infrastructure

EBRD investments in this sector focus on upgrading local facilities, such as municipal wastewater treatment plants, and on raising the service levels of municipal and local utility companies. Reducing costs and increasing the reliability of municipal services can stimulate the development of commercial and industrial enterprises. At the same time, greater access to clean water and sanitation services improves public health and increases public confidence in the transition process and ongoing reform efforts.

Over the last few years, the EBRD has increasingly relied on municipal, as opposed to national, guarantees in this sector, providing local governments with important new financial opportunities and responsibilities. The EBRD's operations policy for municipal and environmental infrastructure emphasizes private sector involvement, the development of appropriate regulatory structures, and improvements in energy efficiency.

As discussed above, the EBRD dedicated part of its 2004 *Transition Report* to a discussion of the challenges and emerging trends in infrastructure services. In 2004, the EBRD provided financing of more than €216 million to projects designed to improve municipal infrastructure and promote energy efficiency.

Energy Sector Investments

Most of the EBRD's countries of operations suffer from severe economic and environmental problems caused by polluting energy systems and inefficient energy pricing. Under its Energy Operations Policy, the Bank promotes energy efficiency through its operations. One of the policy's key objectives is to improve environmental performance, including meeting climate change objectives and supporting renewable forms of energy. The Bank began consultations in 2004 on a new energy policy to update and consolidate its existing Energy Operations and Natural Resources Operations Policies.

The EBRD and Nuclear Safety

Through the Nuclear Safety Account (NSA), 15 donors, including Canada and other Group of Seven (G-7) countries, have continued to work closely with the EBRD to improve nuclear safety in countries of Central and Southeastern Europe and in the former Soviet Union. The NSA is used primarily for making essential safety improvements to older-generation, Soviet-built reactors and to help Ukraine cope with the aftermath of Chernobyl. Total contributions to the NSA are approximately €280 million.

The Bank has continued to administer the Chernobyl Shelter Fund for securing the sarcophagus around the Unit IV reactor in Ukraine (which was destroyed by nuclear accident). The G-7 nations, the EU and other countries have pledged US$716 million (of the original estimate of US$768 million), of which Canada has pledged US$33 million. In 2003, the conceptual design for the new shelter was completed and the overall cost estimated at approximately US$1.1 billion. The construction work on the stabilization of the sarcophagus started in 2004, and the proposals for the detailed design and construction of the new shelter are under evaluation with the contract award planned for the first half of 2005. The project is expected to be completed by the end of 2008, but requires up to US$300 million in additional funds. The G-7/EU are currently discussing financing for up to US$200 million of the shortfall.

Three International Decommissioning Support Funds created in 2000 are operational. They were put in place to assist with the decommissioning of potentially unsafe nuclear reactors in Lithuania (Ignalina Units 1 and 2), the Slovak Republic (Bohunice VI Units 1 and 2) and Bulgaria (Kozluduy Units 1–4).

Discussions between the EBRD and the government of Ukraine on financing for the completion of the Khmelnitsky Unit 2 and Rovno Unit 4 (K2R4) nuclear reactors were concluded in 2004, and EBRD financing of US$42 million was approved in July. Since Ukraine had already completed the K2R4 reactors on its own, the EBRD project's scope is narrower than initially planned and helps finance the post–start-up component of the safety modernization program that will bring the reactors up to international safety standards.

In 2004, the Bank approved a total of US$170 million for two Caspian gas projects: the development of the Shah Deniz gas field and the South Caucasus Gas Pipeline. The pipeline will be built along the route of the Baku-Tbilisi-Ceyhan oil pipeline, a major project developed in cooperation with the World Bank Group and for which the Bank approved financing in 2003. This new EBRD loan is expected to foster improved business and environmental standards at the local partner level and underpin initiatives to ensure transparency and monitoring of project revenues that are so important in the economic development of Azerbaijan, one of the poorest countries in the EBRD's region of operations. The two projects will mean increased, dependable access to gas as a source of energy for Azerbaijan and Georgia, and diversification of supply in the Caucasus.

Addressing Corruption and Poor Governance

The transition countries, like most emerging economies, face significant challenges in improving transparency and governance. As required by its statutes (Article 1 of the Agreement Establishing the European Bank for Reconstruction and Development), the Bank reviews on an annual basis each country's progress towards multi-party democracy, pluralism and a market economy. These principles—which Canada fully supports and encourages—contribute to transparency in public policy making and act as a check on corruption.

From this standpoint, the domestic policies of Belarus, Turkmenistan and Uzbekistan continue to raise concerns as they are difficult to reconcile with the political and economic conditions set out in Article 1 of the Bank's Articles of Agreement. The Bank's country strategies for Belarus and Turkmenistan were renewed in 2004 and, in recognition of these concerns, link the level and nature of the Bank's involvement to the extent of improvement in the political and economic situation. Given the lack of reform progress, these countries continue to be excluded from direct EBRD investments in the state sector. The 2003 strategy for Uzbekistan, reflecting serious concerns, set out seven political and economic benchmarks for reform and scheduled a progress review for the spring of 2004. After monitoring developments over the year, in April 2004, the Bank concluded that very limited progress had been made and decided to restrict its activities to private sector operations and those public sector projects that either finance cross-border activities or clearly benefit the Uzbek people. As part of the regular country strategy updates, the strategy for Uzbekistan will be updated in the summer of 2005.

To a large degree, the EBRD seeks to enhance good governance and transparency in its countries of operations through the projects it undertakes. Equity investments have been an important tool in this regard. The Bank's participation on the boards of directors of companies in which it invests has been instrumental in improving the transparency of their accounting and business practices and their respect for minority shareholder rights. It is hoped that the success of these companies will demonstrate the importance of applying similar practices more broadly in the region. In addition, all Bank business partners are examined to ensure they meet the highest standards of business practice. The Bank routinely seeks the services of forensic accountants and specialized firms to perform integrity checks on companies in which it might invest and on their management and shareholders. For those doing business with the EBRD, the EBRD's procurement policies and rules set the standards of ethics and conduct required during the procurement and execution of EBRD-financed projects.

The Bank's work in the area of legal transition also supports these goals. Under its Legal Transition Programme, the Bank has worked to improve the legal environment in its countries of operations by advancing legal reform in six areas: bankruptcy, company law/corporate governance, concessions, financial market regulation, secured transactions and telecommunications. In addition, the Bank has participated in international standard-setting efforts,

including the World Bank Insolvency Initiative, which seeks to develop international principles of bankruptcy, and the Financial Stability Forum's efforts to coordinate the development and implementation of international financial standards. The Bank also initiated a project with the Russian Federal Commission for the Securities Market to develop a Corporate Governance Code and helped the CIS Inter-Parliamentary Assembly draft a model securities law. To promote transparency the EBRD publishes an annual survey of the extensiveness and effectiveness of various commercial laws in the region in its legal journal, *Law in Transition*. In 2004, the EBRD introduced a new tool, known as a country law assessment, that evaluates core commercial laws using international standards as a benchmark and assesses how laws actually work in practice, drawing on the views of local lawyers working in private practice.

Enhancing Institutional Transparency, Accountability and Governance

The EBRD's Public Information Policy is based on the presumption that information about Bank activities should be made public in the absence of a compelling reason for confidentiality. The following documents are available to the public, with commercially sensitive information deleted as required: draft sectoral policies (for public comment); final sectoral policies; Board-approved country strategies following consultation with the country concerned; summaries of medium- and long-term operational strategies; executive summaries of environmental impact assessments for public and private sector projects; and reports on public sector projects (on a request basis). The Bank's policy requires management to report annually to the Board on the implementation of the Public Information Policy. These findings are made available on the Bank's Web site.

The Bank's Public Information Policy was reviewed and revised in 2003 to enhance transparency and to expand communications with stakeholders. In July 2004, the Bank launched its Independent Recourse Mechanism (IRM), a set of procedures providing for independent review of complaints about Bank-financed projects. The IRM has the mandate to resolve complaints concerning Bank compliance with its own policies. This is in addition to the Manager of Outreach/NGO Relations, who serves as a point of contact between the Bank and the NGO (non-governmental organization) community. The IRM gives local groups, who may be directly and adversely affected by Bank activities, a means of addressing grievances to the Bank—and evaluates whether the Bank has acted in line with its own policies. It includes a problem-solving function to encourage or restore dialogue between parties in an effort to resolve the underlying issues giving rise to a complaint.

To be accountable to its shareholders and its stakeholders, the EBRD evaluates its projects, usually within two years after full disbursement, to assess the extent to which the projects have met their objectives. In 2004, 88 per cent of the Bank's approved projects received a transition impact potential rating of "Good" or "Excellent." From 2005 onwards, the expected

transition impact rating—that is, transition potential adjusted by risk—will be part of the Bank's institutional scorecard.

As part of the international effort to combat the financing of terrorist activities, the Bank adheres to internationally coordinated controls on the illegal use of funds. This includes extensive checks on the integrity of potential clients and monitoring levels of corruption in countries of operations.

Canada has encouraged these policy initiatives. In all international financial institutions (IFIs) in which it is a member, Canada has been at the forefront of efforts to enhance transparency and accountability.

Encouraging Partnerships

The EBRD is required by its founding agreement to involve outside sources of financing in its operations. The Bank plays a key role in attracting co-financiers that might not otherwise be willing to invest in the region. Co-financing has the benefit of increasing a country's access to international capital markets, promoting foreign direct investment and allowing appropriate risk sharing. The EBRD's main co-financing partners are commercial banks, government agencies, export credit agencies and other IFIs. In 2004, the EBRD worked in partnership with commercial banks and other private lenders to achieve a dramatic increase in total co-financing volume, achieving a record commercial co-financing amount of €3.5 billion.

The EBRD also works with donor countries to provide financing for institution building and technical cooperation. Such funding has played a significant role in promoting transition. In 2004, total donor funding received was €82 million and is increasingly used for supporting enhancements to the investment climate in the region. Canada was the sixth largest donor in 2004, with €2.4 million of Canadian technical cooperation funding used for EBRD commitments (projects identified and initiated). Where possible, the EBRD also works with other IFIs in order to extend the impact of the Bank's financing and to benefit from complementarities with the other institutions. In 2004, the EBRD worked with other IFIs on projects involving €682 million in co-financing. Key partners for the EBRD included the International Finance Corporation and the European Investment Bank. Total co-financing from all partners was €5.4 billion in 2004.

Canada has encouraged this cooperation and coordination among multilateral development banks and is pleased with the efforts of the EBRD to work more closely with its sister institutions.

Human Resources

At end of December 2004, the EBRD had regular staff of 965 at its headquarters, unchanged from 2003. Locally hired staff in the Bank's Resident Offices totalled 237, up from 229 in 2003. There are approximately twice as many male professional staff as female professional staff.

Canadian Priorities in 2004

Canada is a strong supporter of the Bank's medium-term operational priorities, which are premised on: the central importance of creating and strengthening those institutions that ensure markets work well; the key role that small businesses can play in creating dynamic, competitive and more equitable economies; and the relevance to the transition process of the Bank's mandate to support countries committed to and applying the principles of multi-party democracy and pluralism.

To achieve these priorities going forward, Canada continues to support the Bank's focus on:

- promoting transparency and accountability in public sector management;
- developing sound financial sectors linked to the needs of enterprises and households;
- providing leadership for the development of micro lending and SMEs;
- developing market-based and commercially oriented infrastructure;
- demonstrating, through selected examples, effective approaches to restructuring viable large enterprises;
- taking an active approach in its equity investments to improve corporate governance;
- engaging governments in policy dialogue to strengthen institutions and improve the investment climate;
- taking a regional approach where appropriate; and
- promoting sustainable development and environmental due diligence.

The EBRD is the only multilateral financial institution that has an explicit requirement that its members be committed to and apply principles of multi-party democracy and pluralism. Canada fully supports this requirement and believes it is appropriate for the Bank to limit its participation in those countries where commitment to the principles embodied in Article 1 is very weak.

Promoting a multilateral rules-based trading system is also a key Canadian priority, and many of the Bank's activities work to support the integration of the transition countries into the world trading system.

The EBRD is committed to working closely and cooperatively with other IFIs and donors in the region. Canada strongly supports this approach. Coordination with other IFIs and donors is an important determinant of the EBRD's effectiveness in promoting the transition to a market economy. Further, the role of other IFIs in addressing poverty directly can complement the EBRD's work in the region.

Managing Canada's Interests

Role of Governors—The highest authority in the Bank is the Board of Governors. A Governor and an Alternate Governor represent each member country. The Honourable Ralph Goodale, Minister of Finance, is the Canadian Governor and Mr. Peter Harder, Deputy Minister of Foreign Affairs, is the Alternate Governor.

Role of the Board of Directors—The Board of Directors, which is responsible for the general operations of the Bank, is composed of 23 members, of which four are non-European members. Canada is the third largest non-European shareholder, after the United States and Japan, and by virtue of its share has the right to elect its own Director. Canada also represents Morocco at the Bank. The Canadian Director is Mr. Scott Clark. The Minister (Economic/Commercial) at the Canadian High Commission in London, Mr. David Plunkett, is the non-resident Alternate Director and represents Canada in the absence of the Canadian Director.

Role of Canadian Government Departments—Within the Canadian government, responsibility for oversight of the EBRD's activities resides with the International Policy and Institutions Division of the Department of Finance. In consultation with the Department of Foreign Affairs, the Department of International Trade and the Canadian International Development Agency (CIDA), the Department of Finance regularly reviews the Bank's policy papers and proposed country strategies and provides advice to the Canadian Director.

Functions of the Canadian Director—In addition to participating in regular Board meetings, the Canadian Director is currently a member of the Board of Directors' Budget and Administrative Affairs Committee, which monitors efficiency, cost control and budgetary prudence, oversees the Bank's human resources policies (including those relating to governance and ethics), and ensures that the Bank's resources are directed towards its priorities. The Canadian Director was an active member of the Audit Committee in 2004, until the Board Committees' memberships were renewed. The Canadian Director continues to participate actively in Audit Committee meetings as well as those of the Financial and Operations Policies Committee.

Positions Taken in 2004—The Canadian Director has frequently spoken to the Board on the importance of the Bank's charter requirement that member countries be committed to market reform and multi-party democracy. In 2004, Canada's Director spoke on the need to address issues related to the disregard for human rights and democratic principles, and actively supported the decision to restrict the Bank's operations in Uzbekistan. Canada's Director also spoke strongly on the need to rigorously apply the additionality test for projects in EU-accession countries and stressed the importance of the Bank's goal of shifting operations to the south and east to early and intermediate transition economies.

To ensure EBRD operations are additional (i.e. the Bank's Articles stipulate that the EBRD should not displace financing available from the private sector on reasonable terms) and contribute to the transition process, Canada continued to advocate increased Bank efforts to find sound projects in countries that are in the early and intermediate stages of transition, that respect the principles of multi-party democracy, and are making efforts at reform. Only by focusing on quality projects will the Bank contribute to advancing transition in these countries. In the advanced transition countries, Canada has insisted on the need for Bank financing to be additional. Therefore Canada has urged the Bank to be increasingly focused and strategic in the advanced transition countries, where private sector financial and capital markets are increasingly active. The Canadian Director abstained from supporting several projects in 2004, due to a lack of additionality.

Canada has also been a strong proponent of greater EBRD transparency, accountability to shareholders and improved internal governance, believing that the Bank should be a model of behaviour for the region.

Canadian Staff at the EBRD—Canadians are well represented on EBRD staff. At the end of 2004, there were 25 Canadian professionals on the staff of the EBRD, representing 3.9 per cent of total professional positions, in line with Canada's 3.4-per-cent share of the institution's capital. It is noteworthy that Canadians fill the following positions: Director of Communications, Director of the Procurement Department and Director of the Early Transition Countries Initiative.

Canada's Voting Record

Canada and other shareholders typically raise concerns and questions about specific Bank operations before they get to the Board. As a result, decisions at the Board are generally taken by consensus. Directors may, however, abstain or vote against projects in consultation with their constituencies. The Canadian Director abstained or voted against the following policies and projects in 2004:

- On the grounds of a lack of additionality: a €15-million loan to PKP Energetyka, an electricity supplier in Poland; a €350-million loan to Slovenske Elektrarne, the Slovak Republic's state-owned electricity generation utility; a €50-million regional facility in favour of Wienerberger AG, a brick and pipe manufacturer; an equity investment of €11.2 million to Uniqua Biztositó, an insurance company in Hungary; and a US$90-million loan to the Russian Standard Bank, the country's pioneer consumer finance institution.
- A €20-million loan in favour of Celsa Huta Ostrowiec, a steel producer in Poland, and a US$35-million loan to ISTIL, a private steel mill in Ukraine, because of concerns about the global overcapacity in the steel industry.
- An €8-million equity investment in International Moscow Bank (IMB), over concerns about an apparent conflict of interest between the Russian central bank's role as both a regulator and shareholder of IMB.

Canadian Commercial Interests

The EBRD offers a number of investment opportunities for Canadian businesses and financial institutions. The objectives of the Canadian Office are to increase Canadian awareness of these investment opportunities, explain how the Bank's financing mechanisms work, and ensure that EBRD policies and procedures are followed in a transparent and fair manner.

To achieve these objectives, the Canadian Office provides EBRD market information and intelligence to Canadian firms and advises Canadian project sponsors on EBRD financing options. In addition, the office develops commercial co-financing opportunities with Export Development Canada and other Canadian financial institutions. Together with the Departments of Foreign Affairs, International Trade and Industry, the office also identifies EBRD procurement opportunities and, with CIDA, promotes Canadian technical cooperation activities and official co-financing with the EBRD.

In 2004, there was one new investment in the region with Canadian sponsor involvement. The EBRD provided a US$10-million loan to Chelopech Mining EAD for environmental remediation, refurbishment and modernization and expansion of the Chelopech mine and processing plant in Bulgaria. Chelopech Mining EAD is 100 per cent owned by Dundee Precious Metals Inc., a public company traded on the Toronto Stock Exchange. In addition, the Board approved EBRD support for Project Vltava through participation of up to €50 million in a bond issue by Cesky Mobil, the third largest mobile phone operator in the Czech Republic. The bond issue will be up to €450 million and will allow Cesky Mobil to upgrade its network to 3G technology. The project was sponsored by a Canadian company, Telesystem International Wireless.

In 2004, 16 contracts that totalled €2.2 million were awarded to Canadian consultants for project preparation, project implementation, and investment climate reform support in the transportation, financial institutions, environment, natural resources, and legal reform sectors. The majority of these assignments were funded through Canadian technical cooperation (TC) funds.

Canada has approved €1.5 million over five years for the EBRD's TurnAround Management Programme, to be used to hire retired and semi-retired Canadians to work as advisors to SMEs in EBRD countries of operations. In 2004, five assignments worth €446,500 were initiated to assist companies in Georgia, Tajikistan, Russia, and Serbia and Montenegro. Under Canada's Phase V EBRD Trust Fund, five new TC assignments were approved by CIDA totalling €1.1 million: two in the Kyrgyz Republic and one each in Russia, Ukraine and Moldova. These assignments were initiated to assist with reforms in the road sector, the aviation industry, standards setting, the deposit insurance industry, pension privatization, and telecommunications. In Southeastern Europe, Canada approved 13 TC assignments under the Canada South East Europe Fund totalling €2.7 million—including five in Serbia and Montenegro, two regional, and one each in Bosnia and Herzegovina, Bulgaria, Albania, Croatia, FYR Macedonia and Romania. The assignments

covered legal reform, transportation, municipal and environmental infrastructure, and financial institutions, including SME credit training. In 2004, Canada also approved a new untied C$2-million fund in the Caucasus and Central Asia that will focus on projects in Baku-Tbilisi-Ceyhan, Tajikistan and Georgia. This new fund supports the Bank's Early Transition Countries Initiative.

Since January 1, 2004, Canada no longer funds technical cooperation assignments in the Central European countries that acceded to the EU in 2004.

In 2005, CIDA and the EBRD will continue to work to align their technical cooperation activities more closely with CIDA programming priorities.

On the commercial co-financing side, Cordiant Capital of Montréal (formerly known as International Finance Pension Trust), has co-financed 15 transactions with the EBRD since 2002, ranking as the EBRD's 10th largest co-financing partner. In 2004, Cordiant participated in 9 EBRD transactions, including a very innovative involvement with a microbank in Ukraine, and the development of its first euro fund.

Looking forward, the EBRD hopes to increase the number of high-quality Canadian project sponsors with whom it invests to better align its official co-financing and technical cooperation needs with Canadian interests in the region, and to strengthen its partnership with Export Development Canada and other Canadian commercial co-financiers.

Promoting Canada's Interests

Members of the Canadian Office made a number of visits to Canada and the EBRD's countries of operations in 2004 to meet with business people, conduct seminars, speak at conferences and consult with government officials. A highlight for the year was the June investor outreach visit to Toronto and Montréal, where the Canadian Director and the EBRD President met with representatives of the Canadian business and investment communities to explain the role of the EBRD and showcase opportunities for Canadian companies.

The following events in 2004 supported by the Canadian Director's office also promoted Canada's interests:

- The EBRD Private Public Partnership Specialist on the Municipal and Environmental Industries Team participated in GLOBE 2004 in Vancouver on April 1, including an Export Development Canada (EDC) roundtable.
- Canadian government officials and business representatives attended the EBRD Annual Meeting in London, England, on April 18–19.
- The Business Advisor for the Canadian Director's office participated in CIDA/Canadian Manufacturers and Exporters sponsored International Development Days in Calgary, April 21–23—including presentations and one-on-one meetings. The Business Advisor met with approximately 30 individuals and companies expressing interest in the region.
- The EBRD's Deputy Head of the Bulgaria office participated in the EDC/Foreign Affairs Bulgarian Business Opportunities Event, held in Montréal on April 29.
- In June, EBRD President Jean Lemierre, Canadian Director Scott Clark, and Business Advisor Sandy Ferguson made an investment promotion visit to Canada. President Lemierre was the keynote speaker at the Conférence de Montréal. The group also had meetings with private sector firms interested in investment in the region in both Montréal and Toronto. This event received excellent media coverage in both the French- and English-language national papers.
- The Business Advisor participated in the Montréal World Trade Centre and partners outreach "Doing Business with Multilateral Development Banks," Sept.14–17 in Montréal, Toronto and Fredericton.
- An EBRD representative for the Trade Facilitation Programme participated in the Ontario Exports Financing seminar on October 14.
- The EBRD's Director of Policy Studies from the Chief Economist's Office and Advisor travelled in December to Ottawa to present to business, academics and government officials key findings of the Bank's 2004 *Transition Report* on developments in the business and economic environments of the Bank's countries of operations.

Members of the Canadian Director's Office in London met with approximately 95 Canadians in 2004, including business people, representatives of financial intermediaries, parliamentarians, representatives from all levels of government, non-governmental organization representatives, consultants and academics.

Challenges Ahead

There were some spectacular developments in the region in 2004, including the accession of eight EBRD countries of operations to the EU in May and the election in Ukraine at year-end. These events are key transition successes.The success of EU accession suggests that the transition to democracy and market economies is all but complete in the new EU countries. In particular, these countries are increasingly able to obtain private sector financing. In the short term, this means that the Bank's activities must increasingly be focused on those areas that represent real additionality and have sufficient transition impact to warrant the use of Bank resources. In the medium term, the transition successes in the EU accession countries—as well as those in the EU candidatures of Romania, Bulgaria and Croatia—elevate the question of the EBRD's Graduation Policy and the future of the Bank itself. These fundamental questions will form the backdrop of the work being done in 2005 for the next Capital Resources Review, which Bank Governors will consider in 2006.

In Russia, high oil prices continue to support high GDP growth, but this also underscores the economy's vulnerability to fluctuations in oil prices and, similar to other resource-rich CIS countries, delays necessary reforms. Priority needs to be given to promoting investment in a wide range of sectors, including the financial sector, and encouraging improved investment climates. In the early transition countries, and to a lesser extent the intermediate transition ones, the challenge continues to be to find quality projects in a high-risk environment that is characterized by a lack of market-supporting institutions. The Bank's new Early Transition Countries Initiative provides a platform for increasing both the effectiveness and the volume of its activities in these countries. The Bank must continue to work in close partnership with other international financial institutions. Expanded cooperation will also be necessary to develop high-transition impact projects with explicit social and poverty alleviation benefits in order to strengthen the willingness of governments in some of the least advanced transition economies to move forward with politically difficult but essential reforms, particularly the restructuring or closure of large state-owned enterprises.

The transition experience of the Bank provides clear lessons for the future. Commitment to market-oriented economic and democratic political reforms along with sound fiscal policies are a prerequisite for sustained economic growth and access to international capital markets, which provide the foundation for further transition successes. Although the relationship between reform and growth is complex, and other factors allow some countries to delay reform while continuing to grow, transition is deepest in those countries that have made progress on economic and democratic reforms. In these economies, market-supporting institutions have tended to develop. These institutional frameworks—predictable fiscal and regulatory environments, secure property rights, an impartial judiciary and sound financial supervision and regulation—combined with commitment to democratic principles, have transformed their citizens' opportunities.

In contrast, in some countries in the Bank's region of operation, particularly those further east, progress in putting in place the institutions that underpin a market economy has been limited, and the process of liberalization and privatization is far from complete. As a result, economic growth remains vulnerable to external and internal shocks. In addition, the significant increase in poverty and inequality since the start of transition has eroded support for necessary reforms in many countries. Overcoming resistance to reform will be a challenge; it will require creating new employment opportunities and social fallback options for those displaced by structural change, and breaking the hold of powerful vested interests over the reform process.

Good governance will continue to play a critical role in the future success of the region and, in this regard, the EBRD will need to find ways to conduct its business to promote its Article 1 commitment to the principles of multi-party democracy and pluralism. In particular, the Bank will continue to monitor the progress of Belarus, Turkmenistan and Uzbekistan. The Bank's financing in Belarus and Turkemenistan is strictly limited to the private sector. As for Uzbekistan, the Board of Directors will revisit its country strategy in the summer of 2005, and will be looking for evidence of progress towards the EBRD's political and economic benchmarks. Given the lack of progress in Uzbekistan since April 2004, the new strategy will likely reflect the existing approach. Canada will continue its vigorous support for Bank efforts to address issues related to the rule of law, human rights and democratic principles.

Good corporate governance will also figure prominently in the period ahead, and the EBRD will need to continue to promote sound institutions, more efficient tax collection and improved legal and regulatory frameworks. It must ensure not only that appropriate legislation is developed, but also that it is properly implemented and enforced.

Finally, good governance within the EBRD itself is also important. Since the EBRD, as a multilateral institution, is not regulated, the Bank must ensure that it adopts and maintains the highest industry standards. To this end, in 2004, the Bank started work on a formal Certification of Internal Controls procedure with the aim of establishing the system by the start of 2005. The formal certification of financial controls will ensure the presence and effectiveness of internal controls, helping to identify and minimize risks. The procedure known as COSO, which was developed in the United States in recent years, is being widely adopted by corporate America, especially in the wake of the Sarbanes-Oxley legislation. COSO is also used by the World Bank. In addition, in 2004, the Board reviewed and renewed the terms of reference for the Bank's Audit Committee. Reviews of the Terms of Reference of the other two Board committees also began in 2004, as did review of the EBRD's Code of Conduct, to ensure they are all in line with best practices; these reviews will be completed in 2005.

Contacting the Office of the Director for Canada

The Canadian Director's office at the EBRD may be reached at:

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For More Information on the EBRD

The Bank releases considerable information on its various activities. Bank publications include information guides (such as *Financing With the EBRD*), special reports (such as the *Annual Report* and *Transition Report*), country strategies and assorted fact sheets.

Information can also be obtained on the Bank's Web site:

http://www.ebrd.com/

Requests for information can be addressed to:

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Annex 1
The Bank's Financial Activities

The Bank's financial activities are divided into ordinary and special operations, depending on the source of funds. Ordinary operations are financed from the ordinary capital resources of the Bank, which comprise subscribed capital, market borrowings, and income from loans and investments. Special operations are those financed by "special funds" for specially designated purposes that are typically outside the Bank's regular activities. Unlike other regional development banks, the EBRD does not operate a concessional or "soft" loan window.

Ordinary Capital Resources

At the end of 2004, the total authorized capital of the Bank was €20 billion. Canada has subscribed to 3.4 per cent—or €680 million (C$958 million)—of the Bank's authorized capital. Canadian contributions to the Bank's capital are made in US dollars (at a pre-determined euro/US$ exchange rate).

In 2004, Canada made its seventh purchase of shares under the first capital increase (which came into effect on April 3, 1997, and doubled the initial €10-billion capital base). Under the first capital increase, 77.5 per cent of Canada's share is "callable," meaning that the Bank can request these resources in the unlikely event that it requires them to meet its financial obligations to bondholders; the balance, or 22.5 per cent, is "paid-in." Payments are being made in eight equal annual installments (40 per cent in cash and 60 per cent in non-interest-bearing demand notes encashed over five years). The following table details Canadian payments to the Bank in US dollars.

Canada's contributions to the Bank's capital are non-budgetary expenditures because our shares in the Bank represent an asset. Nonetheless, Canada's paid-in contributions to the Bank do increase the Government's financing requirements.

Canadian Payments to the EBRD

Year	Notes	Cash	Encashment of notes	Total cash outlay
		(in US dollars)		
1991	11,903,502	11,903,502	11,903,502	23,807,004
1992	11,903,502	11,903,502	3,967,834	15,871,336
1993	11,903,502	11,903,502	7,935,668	19,839,170
1994	11,903,502	11,903,502	11,903,502	23,807,004
1995	11,903,502	11,903,502	11,903,502	23,807,004
1996	–	–	7,935,668	7,935,668
1997	–	–	3,967,334	3,967,334
1998	7,287,199	4,858,132	1,457,439	6,315,572
1999	7,287,199	4,858,132	2,914,878	7,773,010
2000	7,287,199	4,858,132	4,372,317	9,230,449
2001	7,287,199	4,858,132	5,829,759	10,687,891
2002	7,287,199	4,858,132	7,287,198	12,145,331
2003	7,287,199	4,858,132	7,287,199	12,145,331
2004	7,287,199	4,858,132	7,287,199	12,145,331
Total	110,527,903	93,524,434	95,953,503	189,477,937

Market Borrowings

At the end of 2004, total EBRD borrowings stood at €12.2 billion with an average remaining life of 8.3 years at an average cost of funds of LIBOR (London Inter-Bank Offered Rate) minus 34 basis points. Funds have been swapped into floating-rate instruments, primarily in US dollars and euros.

Standard & Poor's has assigned the Bank an AAA long-term and A1+ short-term credit rating. Moody's Investors Service has similarly rated the EBRD long-term bonds AAA.

Special Funds

The EBRD administers a number of bilateral and multilateral technical assistance funds. Canada has contributed to the following special funds:

Canadian Technical Cooperation Fund—The main purpose of this fund is to provide financing to hire Canadian consultants for EBRD projects across a wide range of sectors and EBRD countries of operation. Canada has contributed C$12.65 million since the fund was established in 1992 and is currently completing Canada Phase V.

Chernobyl Shelter Fund—The main purpose of this fund is to secure the sarcophagus around the destroyed Unit IV nuclear reactor in Ukraine. The total estimated cost of this 10-year project is roughly US$1.1 billion, of which US$716 million has been pledged so far. Canada has pledged US$33 million, including US$0.8 million of bilateral assistance for ventilation stack repair.

Nuclear Safety Account (NSA)—This facility was established in 1993 to help finance the closure of the Chernobyl nuclear power plant and to improve safety conditions at nuclear power plants in countries of operations until the plants can be closed. The NSA complements other bilateral and multilateral nuclear safety technical assistance and functions in parallel with multilateral efforts to achieve broader energy sector reform in the region. Canada has contributed C$19.5 million to the total fund of €280 million. Canada's contribution has been completely disbursed.

Russia Small Business Fund (RSBF)—The purpose of this fund is to establish a facility for small business finance and micro lending in various regions of Russia. The RSBF was established in 1993 as a pilot project and became permanent in 1995. Canada has contributed C$11.3 million towards the US$300-million fund.

CIDA-EBRD Cooperation Fund for Southeastern Europe (CFSEE)—By 2002, Canada had contributed C$10 million in support of the EBRD's South Eastern Europe Action Plan, to be used for technical cooperation and co-financing activities. These funds, tied to Canadian consultants, were used in Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FYR Macedonia, Romania, and Serbia and Montenegro. In 2003, an additional C$6 million was added to the CFSEE, which focuses on CIDA priority sectors and countries of focus.

CIDA-EBRD Balkan Region Special Fund (BRSF)—In addition to the CFSEE, Canada has contributed C$2 million to the Balkan Region Special Fund to support post-conflict reconstruction efforts in the Balkan region.

TurnAround Management (TAM) Programme—The TurnAround Management Programme was established in 1993 to match senior industrial advisors from market-driven economies with chief executives of selected firms in the region. The objective is to provide industrial management know-how and develop business skills so that these companies can become competitive and profitable. In 2003, Canada signed a new agreement with the TAM Programme to provide C$2.5 million over five years to be used to hire Canadians to work as advisors. This brought Canada's total contribution to the TAM Programme to C$3.05 million.

Ukraine Micro Finance Bank (MFB)—In 2000, Canada entered into a contribution agreement with the EBRD to provide C$1.25 million for the provision of technical assistance related to the development of the MFB. Over three years, Canada has assisted the MFB to develop a branch network throughout Ukraine, with special attention being paid to Slavutych, the community where many former employees of the Chernobyl nuclear power plant reside. As a greenfield operation specializing in financial services for the micro and small enterprise sector, the MFB is also serving as a demonstration bank for the Ukrainian commercial banking sector to show the commercial viability of micro and small enterprise lending.

Technical Assistance in Support of the Ukraine Micro, Small and Medium-Sized Enterprises Line of Credit II—Between 1999 and 2004, Canada provided C$3 million for technical assistance services by qualified Canadian organizations to Ukrainian commercial banks receiving loans under the EBRD's Ukraine Micro, Small and Medium-Sized Enterprises Line of Credit II for on-lending to micro, small and medium-sized enterprises. The technical assistance has included risk- and loan-evaluation training.

Northern Dimension Environmental Partnership (NDEP)—NDEP provides donor funding to address severe environmental problems in northwest Russia, particularly in the areas of nuclear waste, water and wastewater treatment, and energy efficiency. Within the framework of its mandate, the EBRD supports relevant multilateral and regional agreements on the environment and sustainable development, including the Framework Convention on Climate Change and the measures agreed to in the Kyoto Protocol. Canada became an official contributor to the NDEP Support Fund at the end of 2003 and has committed €20 million. This made Canada the NDEP's sole non-European contributor. Canada earmarked its contribution for the facility's "nuclear window," which counts towards Canada's commitment to the G-8 Global Partnership program. To deal with nuclear waste, the NDEP provides full funding within an international cooperation framework designed to address the complex challenges of cleaning up the legacy of the former Soviet navy's Northern Fleet. In this regard, the NDEP completed a Strategic Master Plan in 2004 that has been adopted by all contributors as the basis for projects in the nuclear window.

CIDA-EBRD Cooperation Fund for Central Asia and the South Caucasus—This C$2-million fund was created in 2004 for work on project preparation and implementation activities in Central Asia and the South Caucasus. The fund targets the following sectors: agribusiness, natural resources, infrastructure financing (e.g. transport, telecommunications, municipal finance), and strengthening institutional capacity development of local institutions working in private sector development and micro-lending institutions. Given CIDA's program focus, priority will be given to projects in Georgia and Tajikistan. This is the first Canadian bilateral fund at the EBRD that is untied (i.e. procurements are not limited to Canadians).

Annex 2

Doing Business With the EBRD

For general information, please refer to www.infoexport.gc.ca/ifinet or contact the Bank's Communications Department in London (tel: +44 20 7338 6096; fax: +44 20 7448 6690).

Further inquiries should be directed to the Office of the Director for Canada, Advisor for Business Development and Investor Relations, Ms. Sandy Ferguson (tel: +44 20 7338 6509; e-mail: fergusos@ebrd.com).

Canadian Project Sponsors: Canadian companies interested in potentially sponsoring a project with the EBRD are requested to direct initial inquiries either to the Office of the Director for Canada, to the Project Inquiries in London (tel: +44 20 7338 6282 or +44 20 7338 6252; fax: +44 20 7338 6102) or to the Bank's resident office in the country of operation. Summaries of EBRD private sector operations can be obtained on the Bank's Web site at http://www.ebrd.com/.

Canadian Suppliers of Goods and Works: The EBRD makes available information on all stages of public sector project development, from the point a project has been identified by the Bank through to its approval. Procurement opportunities and co-financing notices, as well as contract awards information, can be accessed on the Bank's Web site free of charge (see address above).

Canadian Consultants: The EBRD's Web site contains technical cooperation notifications and invitations for expressions of interest for consultancy services pertaining to both public and private sector projects. The EBRD is currently working on an e-Procurement initiative expected to be launched in 2005. This initiative will involve the selection of consultants through a Web-based process.

Current procurement information can be found at http://www.ebrd.com/oppor/procure/index.htm

Individual Canadians: The EBRD maintains a recruitment section on its Web site, which provides information on specific employment competitions at the Bank as they become available. In general, applications for employment for permanent positions and summer jobs should be sent to:

Paolo Gallo, Director for Human Resources
Human Resources Management Department
European Bank for Reconstruction and Development
One Exchange Square
London, EC2A 2JN
United Kingdom

ANNEX 3

EBRD MEMBERSHIP AS AT DECEMBER 31, 2004

	Share of the Bank's capital (%)
European Members	
Austria	2.28
Belgium	2.28
Cyprus	0.10
Denmark	1.20
Finland	1.25
France	8.52
Germany	8.52
Greece	0.65
Iceland	0.10
Ireland	0.30
Israel	0.65
Italy	8.52
Liechtenstein	0.02
Luxembourg	0.20
Malta	0.01
Netherlands	2.48
Norway	1.25
Portugal	0.42
Spain	3.40
Sweden	2.28
Switzerland	2.28
Turkey	1.15
United Kingdom	8.52
European Union	3.00
European Investment Bank	3.00
Non-European Members	
Australia	0.50
Canada	**3.40**
Egypt	0.10
Japan	8.52
Korea, Republic of	1.00
Mexico	0.15
Mongolia	0.01
Morocco	0.05
New Zealand	0.05
United States	10.00

	Share of the Bank's capital (%)
Countries of Operations	
Albania	0.10
Armenia	0.05
Azerbaijan	0.10
Belarus	0.20
Bosnia and Herzegovina	0.17
Bulgaria	0.79
Croatia	0.36
Czech Republic	0.85
Estonia	0.10
FYR Macedonia	0.07
Georgia	0.10
Hungary	0.79
Kazakhstan	0.23
Kyrgyz Republic	0.10
Latvia	0.10
Lithuania	0.10
Moldova	0.10
Poland	1.28
Romania	0.48
Russia	4.00
Serbia and Montenegro	0.47
Slovak Republic	0.43
Slovenia	0.21
Tajikistan	0.10
Turkmenistan	0.01
Ukraine	0.80
Uzbekistan	0.21